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SUPREME COURT, U. S.

APPENDIX

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-439

LEHMAN BROTHERS,

Petitioner,

v.

JACOB SCHEIN; MARVIN H. SCHEIN; ANTONE F. GREGORIO; LUM'S INC.; MELVIN CHASEN; BENJAMIN SIMON; INVESTORS DIVERSIFIED SERVICES, INC.; INVESTORS VARIABLE PAYMENT FUND, INC.; IDS NEW DIMENSIONS FUND, INC.; EUGENE S. SIT; and JAMES R. JUNDT,

Respondents.

No. 73-440

BENJAMIN SIMON,

Petitioner,

v.

JACOB SCHEIN and MARVIN H. SCHEIN,

Respondents.

No. 73-495

INVESTORS DIVERSIFIED SERVICES, INC.; INVESTORS VARIABLE PAYMENT FUND, INC.; and IDS NEW DIMENSIONS FUND, INC.,

Petitioners,

v.

JACOB SCHEIN and MARVIN H. SCHEIN,

Respondents.

INVESTORS DIVERSIFIED SERVICES, INC.,

Petitioner,

v.

ANTONE F. GREGORIO,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITIONS FOR CERTIORARI FILED SEPTEMBER 6, 1973 (Nos. 73-439 and 73-440) AND SEPTEMBER 17, 1973 (No. 73-495)

CERTIORARI GRANTED DECEMBER 3, 1973

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IN THE

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OCTOBER TERM, 1973

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LEHMAN BROTHERS,

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JACOB SCHEIN; MARVIN H. SCHEIN; ANTONE F. GREGORIO; LUM'S INC.; MELVIN CHASEN; BENJAMIN SIMON; INVESTORS DIVERSIFIED SERVICES, INC.; INVESTORS VARIABLE PAYMENT FUND, INC.; IDS NEW DIMENSIONS FUND, INC.; EUGENE S. SIT; and JAMES R. JUNDT,

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INVESTORS DIVERSIFIED SERVICES, INC.,

Petitioner,

v.

ANTONE F. GREGORIO,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Chronological List of Docket Entries

IN THE DISTRICT COURT

(No. 71 Civ. 4218):

JACOB SCHEIN and MARVIN H. SCHEIN,

Plaintiffs,

against

MELVIN CHASEN, INVESTORS DIVERSIFIED SERVICES, INC., LEHMAN BROTHERS, INVESTORS VARIABLE PAYMENT FUND, INC., BENJAMIN SIMON, IDS NEW DIMENSIONS FUND, INC., EUGENE S. SIT, JAMES R. JUNDT, and LUM'S, INC.,

Defendants.

DATE	PROCEEDINGS
9–24–71	Filed Complaint. Issued Summons.
10– 8–71	Filed William P. Dorney, Affdvt of service of letter to offices as indicated on 9-28-71.
11– 3–71	Filed Memorandum of Law in support of deft. Simon's motion to dismiss.
11– 3–71	Filed Affidavits of service, and Affidavits in support of motion.
11– 3–71	Filed MEMO. END. on motions of James R. Jundt and Eugene C. Sit. The motions are granted dismissing actions as to defts. James R. Jundt and Eugene C. Sit. It is so ordered. Tyler, J. (Also in 71 Civil 1925).
11– 3–71	Filed Notice of Motion before Tyler, J. re: dismiss as to deft. Simon.
11– 3–71	Filed MEMO.END. on motion to discuss as to Deft. Simon. Motion is granted. SETTLE ORDER ON NOTICE. Tyler, J.

Chronological List of Docket Entries
Schein v. *Chasen*

DATE	PROCEEDINGS
11–11–71	Filed Summons with Marshal's ret. Served; Lum's Inc. by Mr. Ben Pearlson, on 9-29-71 Melvin Chasen, by Ben Pearlson, on 9-29-71 Investors Diversified Services, Inc. by Raleigh Z. Goldberg, on 9-27-71 Investors Variable Payment Fund, Inc. by Wm. C. Herber, on 9-27-71 IDS New Dimensions Fund, Inc. by Wm. C. Herber, on 9-27-71 Eugene S. Sit, on 9-28-71 James R. Jundt, on 9-29-71 Lehman Brothers, by Mr. Huges, on 9-28-71 Benjamin Simon, by Ben Jamin, on 9-28-71
11–15–71	Filed Order STAYING all proceedings in this action and 4 others, up to and including 10 days following the filing of orders denying motions to dismiss. (Filed in 70 Civil 5331). (mailed notice).
12–16–71	Filed OPINION #38113. Tyler, J. Deft. Chasen's motion to dismiss is granted. The motions of the remaining defts. to dismiss are hereby granted. In view of these rulings, defendants' alternative motion for a stay of these actions need not be reached. SETTLE ORDERS accordingly. (mailed notice).
12–16–71	Filed defts' Investors Diversified Service, Inc. and IDS New Dimensions Fund, Inc. Memorandum in support of Motion to dismiss. Filed in 70 Civil 5733
12–16–71	Filed defts' Investors Diversified Service, Inc. and IDS New Dimensions Fund, Inc. Reply Memorandum in support of Motion to Dismiss or Stay.

Chronological List of Docket Entries
Schein v. *Chasen*

DATE	PROCEEDINGS
12–16–71	Filed deft. Chasen Reply Memorandum in support of motion to dismiss. (Filed in #70 Civ. 5733).
12–16–71	Filed Pltfs'. Schein & Gregorio Memorandum in opposition to defts'. motion to dismiss. (Filed in #70 Civ. 5733).
12–16–71	Filed Deft. Investors Diversified Service Inc. Memorandum in support of motion. (Filed in #70 Civ. 5733).
12–16–71	Filed deft. Lehman Bros. Reply Memorandum in support of motion to dismiss. (Filed in #70 Civ. 5733).
12–16–71	Filed deft. Lehman Bros. Memorandum in support of motion to dismiss. (Filed in #70 Civ. 5733).
12–16–71	Filed Affidavit of Melvin Chasen in support of motion of certain defendants to dismiss for failure to state a claim.
12–16–71	Filed deft. Melvin Chasen Affidavit & Notice of joinder in motion on behalf of IDS, Inc., IDS, New Dimensions Fund Inc., Sit, Jundt & Simon to dismiss complaints before Tyler, J. (Filed in #70 Civ. 5733).
12–16–71	Filed Reply Memorandum in support of Motion to dismiss or stay. (Filed in 71 Civ. 1925).
12–16–71	Filed Reply Memorandum in support of deft. Simon's motion to dismiss and for summary Judgment.

Chronological List of Docket Entries
Schein v. *Chasen*

DATE	PROCEEDINGS
1– 6–72	Filed Notice of Settlement and Order. Ordered that the above entitled actions are dismissed with prejudice and without costs. Tyler, J. (mailed notice).
2– 4–72	Filed Notice of Appeal by Jacob Schein and Marvin H. Schein. (mailed copies)
3–16–72	Filed stipulation and order extending the time by which the records on appeal in actions 71 Civil 1925, 70 Civ. 5733 and 71 Civil 4218 shall be transmitted to the Court of Appeals, to 3/22/72. (Filed in 70 Civil 5733). Tyler, J.
12–16–71	Filed Memorandum of Law in support of deft. Simon's motion to dismiss and for summary judgment
4– 5–72	Filed Certified Record on Appeal to the USCA.

Chronological List of Docket Entries
Schein v. *Chasen*

IN THE COURT OF APPEALS

No. 72-1373

DATE	PROCEEDINGS
2-14-72	Filed copies of docket entries and notice of appeal.
3-16-72	Filed copies of docket entries and notice of appeal (Gregorio) (& in 72-1375).
4- 5-72	Filed record (original papers of district court).
4- 5-72	Filed record (original papers of district court). (71 Civ. 1925). (Filed in 72-1375).
5-15-72	Filed order extending time to file appellant's brief and appendix to 6-14-72 (Schein).
5-15-72	Filed order extending time to file appellant's brief and appendix to 6-14-72 (Gregorio) (Filed in 72-1375).
6-14-72	Filed appendix with proof of service (& in 72-1375).
6-14-72	Filed brief, appellants with proof of service (& in 72-1375).
7-11-72	Filed order extending time to file appellees brief to 8-15-72 (& in 72-1875).
7-20-72	Filed motion for leave to file supplemental appendix with proof of service (& in 72-1375) (Simon).
7-21-72	Filed motion for leave to file supplemental appendix with proof of service (Lehman) (and in 72-1375).

Chronological List of Docket Entries
Schein* v. *Chasen

DATE	PROCEEDINGS
7–21–72	Filed order granting leave to file a supplemental appendix (Simon).
7–21–72	Filed order granting leave to file a supplemental appendix (Lehman) (& in 72-1375).
7–26–72	Filed notice of appearance.
8–15–72	Filed brief, appellees (IDS, IVPF and IDS New Dimensions Fund, Inc.) with proof of service (& in 72-1375).
8–15–72	Filed supplemental appendix, (Simon and Lehman) with proof of service (& in 72-1375).
8–15–72	Filed brief, appellees (Simon and Lehman) with proof of service (& in 72-1375).
8–24–72	Filed order extending time to file appellant's reply brief to 9/13/72.
9–12–72	Filed stipulation (endorsed) extending time to file reply brief to 10-4-72.
10– 3–72	Filed reply brief, appellant with proof of service (& in 72-1375).
10–17–72	Argument heard by: Waterman, Smith, Kaufman, CJJ (& in 72-1375).
5–10–73	Judgment Reversed and Action Remanded, Waterman, CJ (& in 72-1375).
5–10–73	Dissenting in separate opinion, Kaufman, CJ (& 72-1375).
5–10–73	Filed judgment (& in 72-1375 Greg v. Lums) w/c.
5–24–73	Filed itemized and verified bill of costs.

Chronological List of Docket Entries
Schein v. *Chasen*

DATE	PROCEEDINGS
5–24–73	Filed petition for rehearing and rehearing en banc, p/s (IDS, etc.) (& in 72-1375).
5–24–73	Filed petition for rehearing in banc, p/s (Lehman Bros.).
5–24–73	Filed petition for rehearing in banc, p/s (Simon).
6– 8–73	Filed order denying petition for rehearing in banc (Lehman Bros.).
6– 8–73	Filed order denying petition for rehearing in banc (Simon).
6–18–73	Filed order denying petition for rehearing (IDS).
6–18–73	Filed order denying petition for rehearing in banc (IDS).
7–24–73	Filed statement of costs.
7–24–73	Issued Mandate (opinion, judgment & statement of costs).

Chronological List of Docket Entries
Gregorio v. *Lum's, Inc.*

IN THE DISTRICT COURT

(No. 71 Civ. 1925):

ANTONE F. GREGORIO, individually and as representative of all persons similarly situated as a class under Rule 23 FRCP,

Plaintiff,

against

LUM'S, INC., MELVIN CHASEN, LEHMAN BROTHERS, BENJAMIN SIMON, INVESTORS DIVERSIFIED SERVICES, INC., EUGENE C. SIT, JAMES R. JUNDT,

Defendants.

DATE	PROCEEDINGS
4–30–71	Papers originally filed in Northern District of Illinois, Chicago 60604, were this day filed:— Complaint, Designation, Affidavit, etc. (see papers).
	RECORD OF PROCEEDINGS—S.D.N.Y.
5– 3–71	Filed stip and order that time for defts, Investors Diversified, Eugene C. Sit, and James R. Jundt, to Answer the complaint is extended to 6-11-71 Tenny J.
5–10–71	Filed Order that the time of deft Lum's Inc. to Answer the complaint is extended to 6-11-71 Tenney J.
5–11–71	Filed stip and order that time for deft Lehman Brothers to Answer the complaint is extended to 6-11-71 Tenney J.

Chronological List of Docket Entries
Gregorio v. *Lum's, Inc.*

DATE	PROCEEDINGS
6–15–71	Filed affidavit of service of letter upon attorneys listed.
6–30–71	Placed copy of notice of motion re: Dismiss Complaint. Ret. 7/9/71 in folder. (Filed in 70 Civ. 5355).
6–30–71	Placed copy of Memorandum in support of deft. Lehman Bros.' motion to dismiss in folder. (Filed in 70 Civ. 5355).
7–23–71	Filed Notice of Joinder in Motion (by Royall, Koegel & Wells for deft's. Lum's Inc.) (Filed in 75 Civ. 5355).
7–23–71	Filed Notice of Joinder in Motion (by Donovan, Leisure, Newton & Irvine) for defts. Investors Diversified Services, Inc., Thomas R. Reeves, R. Austin Hume, James A. Murray, Eugene C. Sit and James R. Jundt.
7–23–71	Filed MEMO. END. on copy of motion papers filed 6/30/71. Motion to dismiss granted with leave to plaintiff to replead, if he can, within 20 days hereof. Tyler J.
8–11–71	Filed Amended Complaint, and jury demand.
10– 8–71	Filed Affidavit of service of letter to offices as indicated on 9/28/71.
11– 3–71	Filed Affidavits of service, and Affidavits in support of motion.
11– 3–71	Filed MEMO. END. on motions of James R. Jundt and Eugene C. Sit. The motions are granted dismissing the actions as to defts. James R. Jundt and Eugene C. Sit. It is so ordered. Tyler, J. (Filed in 71 Civil 4218).

Chronological List of Docket Entries
Gregorio v. *Lum's, Inc.*

DATE	PROCEEDINGS
11–15–71	Filed Order Staying All proceedings in this action and 4 others, up to and including 10 days following the filing of orders denying motions to dismiss. (Filed in 70 Civil 5331). (mailed notice).
12–16–71	Filed Opinion #38113, Tyler, J. Deft. Chasen's motion to dismiss is granted. The motions of the remaining defts. to dismiss are hereby granted. In view of these rulings, defendants' alternative motion for a stay of these actions need not be reached. Settle Orders accordingly. Tyler, J. (mailed notice).
12–16–71	Filed Deft. Investors Diversified Service, Inc., Memorandum in Support of Motion to Dismiss. Filed in 70 Civ. 5733.
12–16–71	Filed Deft. Investors Diversified Service, Inc., Reply Memorandum in support of motion to dismiss or stay.
12–16–71	Filed deft. Chasen Reply Memorandum in support of motion to dismiss (Filed in 70 Civ. 5733).
12–16–71	Filed Pltfs'. Schein & Gregorio Memorandum in opposition to defts'. motion to dismiss. (Filed in 70 Civ. 5733).
12–16–71	Filed Deft. Investors Diversified Service Inc. Memorandum in support of motion. (Filed in 70 Civ. 5733).
12–16–71	Filed deft. Lehman Bros. Reply Memorandum in support of motion to dismiss. (Filed in 70 Civ. 5733).

Chronological List of Docket Entries
Gregorio v. *Lum's, Inc.*

DATE	PROCEEDINGS
12–16–71	Filed deft. Lehman Bros. Memorandum in support of motion to dismiss. (Filed in 70 Civ. 5733).
12–16–71	Filed Affidavit of Melvin Chasen in support of certain defendants to dismiss for failure to state a claim. (Filed in 70 Civ. 5733).
12–16–71	Filed deft. Melvin Chasen Affidavit & Notice of joinder in motion on behalf of IDS, Inc., IDS, New Dimensions Fund, Inc., Sit, Jundt & Simon to dismiss complaints before Tyler, J. (Filed in 70 Civ. 5733).
12–16–71	Filed Reply Memorandum in support of motion to dismiss or stay (Filed in 71 Civ. 1925).
1– 6–72	Filed Notice of Settlement and Order. Ordered that the above entitled actions are dismissed with prejudice and without costs. Tyler, J. (mailed notice).
1– 5–72	Filed transcript of Record of Proceedings of 9/30/71.
2– 4–72	Filed Notice of Appeal. (mailed notice).
3–16–72	Filed stipulation and order extending the time by which the records on appeal in actions 71 Civil 1925, 70 Civ. 5733 and 71 Civ. 4218 shall be transmitted to the Court of Appeals, to 3/22/72. (Filed in 70 Civ. 5733) Tyler J.
4– 5–72	Filed Certified Record on Appeal to the U.S.C.A.

Chronological List of Docket Entries
Gregorio v. *Lum's, Inc.*

IN THE COURT OF APPEALS

(No. 72-1375):

DATE	PROCEEDINGS
3–16–72	Filed copies of docket entries and copy of notice of appeal
4– 5–72	Filed record (original papers of district court)
5–15–72	Filed order extending time to file appellant's brief and appendix to 6-14-72
6–14–72	Filed appendix with proof of service (Filed in 72-1373)
6–14–72	Filed brief, appellants with proof of service (Filed in 72-1373)

Pleadings

Complaint in Schein v. Chasen

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

71 Civ. 4218 HRT

Plaintiffs Demand A Trial By Jury

JACOB SCHEIN & MARVIN H. SCHEIN,

Plaintiffs,

v.

MELVIN CHASEN, INVESTORS DIVERSIFIED SERVICES, INC., LEHMAN BROTHERS, INVESTORS VARIABLE PAYMENT FUND, INC., BENJAMIN SIMON, IDS NEW DIMENSIONS FUND, INC., EUGENE S. SIT, JAMES R. JUNDT and LUM'S, INC.,

Defendants.

Plaintiffs, by their attorneys Wolf Popper Ross Wolf & Jones, complaining of the defendants, allege upon information and belief, except as to Paragraphs 1, 2, 5 and 7, which are alleged upon knowledge:

1. Plaintiffs, citizens of the State of Maryland, are the owners and holders of the stock of Lum's, Inc. ("Lum's"). They were such owners and holders at the time of the acts and transactions complained of herein and continuously to date.

2. Plaintiffs bring this action derivatively on behalf of and for the benefit of Lum's.

3. Jurisdiction of this action is based upon diversity of citizenship.

4. The amount in controversy exceeds $10,000 exclusive of interest and costs.

5. This action is not a collusive one to confer upon this Court jurisdiction it otherwise would not have.

6. All of the defendants are citizens of states other than Maryland.

7. On December 10, 1970, prior to the institution of four stockholders' suits commenced in the United States District Court and dealing with the same subject matter, plaintiffs commenced a derivative action on behalf of Lum's in the New York State Supreme Court, New York County (*Schein* v. *Investors Diversified Services, Inc., et al.*, Index No. 02968/1971) alleging the same cause of action set forth in this action. On June 17, 1971, an order was entered staying prosecution of that action pending final determination of actions pending in the federal court.

8. Lum's is incorporated in the State of Florida. It transacts business in the State of New York. Its common stock is traded on the New York Stock Exchange, a national securities exchange located in the Southern District of New York. At the relevant times hereinafter alleged, Lum's was engaged principally in franchising fast food restaurants and on September 30, 1969, it acquired Caesar's Palace, a large hotel casino in Las Vegas, Nevada.

9. Investors Diversified Services, Inc. ("IDS") is incorporated in Minnesota. It is licensed to do business and

transacts business in the State of New York. IDS maintains an office for the transaction of business in the Southern District of New York. IDS is the distributor and investment advisor for a number of large mutual funds including Investors Variable Payment Fund, Inc. ("Investors") and IDS New Dimensions Fund, Inc. ("Dimensions").

10. Investors and Dimensions are mutual funds which invest their funds principally in common stocks.

11. Lehman Brothers ("Lehman") is a partnership, engaged in the stock brokerage and investment advisory business with its principal office located in the Southern District of New York.

12. Melvin Chasen ("Chasen") was at the times of the acts and transactions hereinafter alleged the chief operating officer of Lum's.

13. Benjamin Simon ("Simon") was at the times of the acts and transactions hereinafter alleged an institutional salesman for Lehman.

14. At the times hereinafter alleged, Eugene C. Sit ("Sit") was portfolio manager of Dimensions and James R. Jundt ("Jundt") was manager of and an analyst for Investors.

15. In or about November, 1969, Chasen informed approximately sixty members of the securities industry, including Sit and Jundt, at a seminar given by Lum's, that projected earnings for Lum's for its fiscal year ending July 31, 1970 would be approximately $1.00 to $1.10 per share.

16. On or about January 5, 1970, Chasen, by virtue of his position with Lum's and in connection with his fiduciary relationship with Lum's, learned that Lum's earnings estimate for the second quarter ending January 31, 1970 projecting an earnings increase of $3,200,000 was incorrect. He also learned that the earnings would show an increase of only approximately $750,000 for the quarter and per share earnings for the fiscal year ending July 31, 1970 would only be 76 cents per share.

17. On or about January 8, 1970, Chasen divulged the material information set forth in paragraph "16" to Simon and to others presently unknown to plaintiffs prior to the public disclosure of said inside information. Chasen also informed Simon and the others that the disappointing earnings were caused by problems in Lum's restaurant division, lower franchise sales and disappointing results at Caesar's Palace, a Las Vegas hotel casino owned by Lum's. This information was also given prior to its public disclosure.

18. The material non-public information set forth in paragraphs "16" and "17" was confidential, the property of Lum's and could not be used for any private purposes.

19. On or about January 8, 1970, after the close of the stock market, Simon divulged the non-public information set forth in paragraphs "16" and "17" given to him by Chasen to Sit and Simon informed Sit of the confidential nature and source of the information. Sit, in turn, immediately conveyed the information to Jundt, advising him of the source of the information and that it was confidential.

20. Before the opening of the stock market on January 9, 1970, Sit and Jundt, with knowledge of the non-public information set forth in paragraphs "16" and "17" and the nature and source of said information, directed the sale by Investors and Dimensions of their entire stock holdings in Lum's.

21. On the morning of January 9, 1970, Investors sold 43,000 shares of Lum's and Dimensions sold 40,000 shares of Lum's. Others, whose identities are presently unknown to plaintiffs, having received the same confidential information, likewise sold shares of Lum's stock. The sales were executed on the New York Stock Exchange at and about 10:30 A.M. (EST) and prior to 1:30 P.M. (EST) at approximately $17.50 per share. Said transactions were effected prior to the public disclosure of the material information set forth in paragraphs "16" and "17" and without the sellers having made any disclosure of the information and knowing that they had received confidential information that belonged to Lum's.

22. At 1:30 P.M. (EST) on January 9, 1970, the New York Stock Exchange halted trading in Lum's stock pending a company announcement.

23. At or about 2:45 P.M. (EST) on the afternoon of January 9, 1970, defendant Lum's issued the following release which appeared on the Dow Jones News Wire Service (the so-called broad tape):

> Lum's Inc., today announced that projected earnings for the second fiscal quarter will be substantially lower than had been anticipated. As a result, earn-

ings for the first six months of the fiscal year will be approximately 20% lower than the previous year.

Mr. Melvin Chasen, Executive Vice President explained that lower earnings were due to smaller profits than had been anticipated from Lum's Restaurant Corporation and less revenue than had been projected for the second quarter from the Caesar's Palace Division.

Mr. Chasen said he anticipated that second half earnings would be significantly higher.

The Dow Jones announcement was the first public disclosure of the adverse earnings information set forth in paragraphs "16" and "17" above.

24. Trading in Lum's stock was not resumed until 10:00 A.M. (EST) on January 12, 1970. Price and volume activity of Lum's common stock on the New York Stock Exchange from Monday, January 5, 1970, the day defendant Chasen received information concerning Lum's adverse earnings for the second quarter of Lum's fiscal year, through Monday, January 12, 1970 was:

Date	*Vol.*	*Open*	*High*	*Low*	*Close*
1/5	20,600	20¾	21½	20⅜	20½
1/6	12,900	20⅝	20⅝	19⅝	19¾
1/7	13,400	19½	19⅞	19½	19¾
1/8	15,100	19½	19⅝	19	19
1/9	325,500	18⅞	18⅞	16½	16⅞
1/12	393,000	14	14⅝	13	14

25. By reason of the facts set forth above, Chasen had the fiduciary obligation to Lum's and its stockholders not to

divulge the confidential information received by him as Vice-President and Chief Executive Officer of Lum's. In willful and blatant disregard thereof, he tipped off Lehman, Simon and others, knowing they would use this information for their own personal benefit. Chasen thereby violated his fiduciary duties to Lum's. All of the other defendants, other than Lum's and others presently unknown to plaintiffs, aided and abetted Chasen in the violation of his fiduciary duties and used the aforesaid confidential information for their own personal profit. By reason thereof all of the defendants are liable to Lum's for their unlawful profits (including commissions) and are liable to Lum's for the damages it sustained thereby.

26. As a result of the acts and transactions aforesaid, the defendants, other than Lum's, profited and Lum's has sustained substantial damage, the precise amount of which is presently unknown to plaintiffs and ascertainable only upon a full and complete accounting herein.

27. Many of the acts complained of herein were committed in the Southern District of New York, either originating or being consummated herein.

28. Plaintiffs demand punitive damages.

29. Plaintiffs have no adequate remedy at law.

30. Demand upon the Board of Directors of Lum's to bring this action was not made and would have been futile because Chasen is the Chief Operating Officer of Lum's, Lehman has in the past and continues to render substantial investment and advisory services to Lum's and its

Board of Directors and IDS and the selling defendants either control large purchases or are purchasers of large blocks of stock in Lum's. Due to the foregoing, the Board of Directors of Lum's would not prosecute an action against these aforementioned defendants or their employees, or if such suit was brought, it would not be prosecuted diligently.

31. Demand upon the stockholders of Lum's to bring this action was not made and would have been futile because the wrongs to Lum's alleged herein are incapable of stockholder ratification. Under the law the directors and officers, not the stockholders, are vested with the management of Lum's, including the institution of all actions in behalf of Lum's. The stockholders as a body cannot by resolution compel the directors to institute a suit in behalf of Lum's. Such resolution in any event would be futile and useless for the reasons stated in paragraph "30". The stockholders of Lum's are very numerous and are located throughout the United States and abroad. It would place an unreasonable burden and expense on plaintiff, and extended delays would result which would be harmful and prejudicial to the prosecution of this action if plaintiffs were compelled to make such demand on the stockholders.

WHEREFORE, plaintiffs demand judgment:

1. Holding that all the defendants, other than Lum's, account to Lum's for all its losses and damages and pay to Lum's all of the profits derived by them by virtue of the acts and transactions complained of herein.

2. Holding that defendants other than Lum's pay punitive damages.

3. Ordering that plaintiffs be awarded the costs and disbursements of this action, including reasonable counsel and accountants' fees.

4. Granting such other and further relief as this Court may deem just and proper.

WOLF POPPER ROSS WOLF & JONES
By HOWARD L. JACOBS
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(Jurat Omitted in Printing)

Amended Complaint in Gregorio v. Lum's, Inc.

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

71 Civ. 1925 HRT

(Jury Trial Demanded)

Shareholders Derivative Action

ANTONE F. GREGORIO,

Plaintiff,

vs.

LUM'S INC., MELVIN CHASEN, LEHMAN BROTHERS, INVESTORS DIVERSIFIED SERVICES, INC., EUGENE C. SIT, and JAMES R. JUNDT,

Defendants.

Plaintiff, ANTONE F. GREGORIO, by his attorneys, alleges of the Defendants as follows:

Jurisdiction and Venue

1. This court has jurisdiction of the parties and subject matter based upon diversity of citizenship. Plaintiff resides in the State of Illinois. All Defendants reside in or are corporations maintaining their principal offices in States other than Ilinois. In addition, the amount in controversy exceeds $10,000 exclusive of interests and costs. This action is not brought to confer jurisdiction upon this Court which it would not otherwise have.

2. The Defendants, Lum's, Inc., Lehman Brothers and Investors Diversified Services, Inc. transact business and

are found within the Southern District of New York. The unlawful acts alleged hereinafter have been performed, in part, within the Southern District of New York.

Plaintiff

3. Plaintiff is a purchaser and owner of the common stock of Lum's, Inc. and is a resident of Illinois.

4. Plaintiff brings this action derivatively on behalf of Lum's.

5. Plaintiff's purchases of Lum's, Inc. were made in 1969, and on January 5, 1970, Plaintiff owned 1,500 shares of common stock, listed on the New York Stock Exchange. Plaintiff has suffered substantial losses from the decline in this security as a result of the unlawful acts of the Defendants named herein.

Defendants

6. Defendant, Lum's, is a corporation which was incorporated under the laws of Florida, having its principal place of business at 5050 Biscayne Boulevard, Miami, Florida. The common stock of Defendant, Lum's, Inc. is traded on the New York Stock Exchange, a national securities exchange which is located in the Southern District of New York. Defendant, Lum's, Inc., is primarily engaged in franchising fast-food restaurants and on September 30, 1969, it acquired Caesar's Palace, a large hotel-casino in Las Vegas, Nevada.

7. Defendant, Chasen, has been the Chief Operating Officer and a director of Defendant, Lum's, Inc., from

October 1968 to the present. On or about February 6, 1970, Defendant, Chasen, became President of Defendant, Lum's, Inc. Chasen dominates and controls Lum's Board of Directors so that if Lum's, Inc. brought this action it would be conducted under the control of the Directors, who are themselves controlled by Defendant, Chasen; thereby leaving Chasen in charge of a lawsuit against himself.

8. Defendant, Lehman Brothers, is a broker-dealer firm located at One Wiliam Street, New York, New York. The firm is registered with the Securities and Exchange Commission as a broker-dealer in securities pursuant to Section 15 of the Exchange Act (15 U.S.C. 78e), is a member of the New York, American and other major stock exchanges, and is also a member of the National Association of Securities Dealers ("NASD").

9. Defendant, Investors Diversified Services, Inc., with its principal offices located at Investors Building, Minneapolis, Minnesota, was established in 1894. It manages investments aggregating some six billion dollars in market value for six open-end registered investment companies. The six companies include Investors Mutual, Inc.; Investors Selective Fund, Inc.; Investors Stock Fund, Inc.; Investors Variable Payment Fund, Inc.; IDS New Dimensions Fund, Inc.; and IDS Progressive Fund, Inc. Defendant, Investors Diversified Services, Inc. is registered with the Securities & Exchange Commission as a broker-dealer in securities pursuant to Section 15 of the Exchange Act.

10. Defendant, Sit, is employed by Defendant, Investors Diversified Services, Inc. He joined Defendant, Investors

Diversified Services, Inc., on August 26, 1968 as an Associate Portfolio Manager of Investors Stock Fund, Inc. and was promoted to the position of Portfolio Manager of Defendant, Investors Diversified Services, Inc.'s IDS New Dimensions Fund, Inc. in November, 1969. His responsibilities include assisting in the management of Investors Diversified Services, Inc.'s six funds. Defendant, Investors Diversified Services, Inc.'s IDS New Dimensions Fund, Inc. had in its portfolio as of January 8, 1970, 40,000 shares of Defendant, Lum's, Inc., common stock with a cost value of approximately $730,000.

11. Defendant, Jundt, has been employed by Defendant, Investors Diversified Services, Inc., since July 28, 1969. He was first employed as an analyst, specializing in the fields of hotels, restaurants, and franchises. In December of 1969, he was promoted to the position of analyst and a satellite manager of the Defendant, Investors Diversified Services, Inc.'s Investors Variable Payment Fund, Inc. On February 18, 1970, Jundt was further advanced to the position of Group Director of the Moderate Growth Group. Investors Variable Payment Fund, Inc. had in its portfolio as of January 8, 1970, 43,000 shares of Defendant, Lum's, Inc., common stock with a cost value of approximately $1,400,000.

Cause of Action

12. During the period from approximately December, 1969 to date hereof, Defendants, Lum's, Inc., Chasen, Leh-

man Brothers, Investors Diversified Services, Inc., Sit and Jundt, singly and in concert, directly and indirectly, in connection with purchases and sales of securities of Defendant, Lum's, Inc., by use of the means or instrumentality of interstate commerce, or of the mails, or of the facility of the New York Stock Exchange, a national securities exchange, have employed and are employing devices, schemes and artifices to defraud, and have been engaging in acts, practices and courses of business which have operated and are operating as a fraud and deceit upon the shareholders of Defendant, Lum's, Inc. and other purchasers and sellers and prospective purchasers and sellers of Defendant, Lum's, Inc., securities.

13. In or about November 1969, at a seminar given by Lum's, Inc. at Caesar's Palace which was attended by approximately sixty members of the securities industry including Defendants, Simon and Sit, Defendant, Chasen, stated that the projected earnings of Lum's, Inc. for its fiscal year ending July 31, 1971 was in the neighborhood of $1.00 to $1.10 per share.

14. On or about January 5, 1970, Defendant, Chasen, received from Lum's, Inc. Assistant Treasurer a revised income schedule entitled "Consolidated Projection of Income—(Revised)," which schedule indicated unexpected and disappointing earnings for the second quarter of Lum's, Inc. 1970 fiscal year ending January 31, 1970. The schedule reflected a revised projected gain for the second quarter of about $750,000, as compared with an original projected

gain of $3,200,000. The schedule also disclosed a revised yearly estimated earnings figure of $0.76 per share for the fiscal year ending July 31, 1971. None of this information had been made public.

15. Defendant, Chasen, conveyed to Defendant, Simon, on or about January 8, 1970, material non-public information concerning the matters set forth in paragraph 14 above and explained to Simon that troubles in the restaurant division, lower franchise sales, and disappointing results at Caesar's Palace were the causes of the disappointing earnings.

16. Thereafter, on January 8, 1970, Defendant, Lehman, conveyed to Defendant, Sit, material non-public information concerning the matters set forth in paragraphs 14 and 15 above.

17. On January 8, 1970, immediately after the above-mentioned telephone conversation, Defendant, Sit, at a meeting in his office communicated material non-public information concerning the matters set forth in paragraphs 14 and 15 above, to Defendant Jundt. Defendants, Sit and Jundt, then decided to sell IDS New Dimensions Fund, Inc.'s entire position of 40,000 shares of Lum's, Inc. common stock and Investors Variable Payment Fund, Inc.'s entire position of 43,000 shares of Lum's, Inc. common stock.

18. On the following morning (January 9, 1970) at about 9:40 A.M. (EST) Defendants, Sit and Jundt, having knowledge and information of non-public material facts

concerning the matters set forth in paragraphs 14 and 15 above, placed an order with Investors Diversified Services, Inc. trading room to immediately sell on behalf of IDS New Dimensions Fund, Inc. and Investors Variable Payment Fund, Inc. their entire holdings of Lum's Inc. common stock consisting of 83,000 shares. The order was executed at about 10:30 A.M. (EST) at approximately $17½ per share on the New York Stock Exchange, without disclosing to the purchasers the aforementioned material nonpublic information concerning Lum's, Inc. The total price of the sale was approximately $1,453,000.

19. Thereafter, at 1:30 P.M. (EST) on January 9, 1970, the New York Stock Exchange halted trading in Defendant, Lum's, Inc., common stock pending a company announcement.

20. At or about 2:45 P.M. (EST) on the afternoon of January 9, 1970, Defendant, Lum's Inc., issued the following release which appeared on the Dow Jones News Wire Service (the so-called broad tape).

> Lum's Inc., today announced that projected earnings for the second fiscal quarter will be substantially lower than had been anticipated. As a result, earnings for the first six months of the fiscal year will be approximately 20% lower than the previous year.
>
> Mr. Melvin Chasen, Executive Vice President explained that lower earnings were due to smaller profits than had been anticipated from Lum's Restaurant Corporation and less revenue than had been projected for the second quarter from the Caesar's Palace Division.

Mr. Chasen said he anticipated that second half earnings would be significantly higher.

The Dow Jones announcement was the first public disclosure of the adverse earnings information set forth in paragraphs 14 and 15 above.

Effects of Violations

21. Trading in Lum's, Inc. stock was not resumed until 10:00 A.M. (EST) on January 12, 1970. Price and volume activity of Lum's, Inc. common stock on the New York Stock Exchange from Monday, January 5, 1970, the day Defendant, Chasen, received information concerning Lum's, Inc. adverse earnings for the second quarter of Lum's, Inc. fiscal year, through Monday, January 12, 1970 varied from a low volume on January 6, 1970 of 12,900 shares to a high on January 12, 1970 of 393,000 and from a high price on January 5, 1970 of 20½ at close to a low of $14 on January 12, 1970.

22. The non-public information was an asset of Defendant, Lum's Inc., and belonged to it. Defendants must account to Lum's Inc. for the profits realized by them.

23. Demand upon the Board of Directors of Lum's Inc. to bring this action would be futile because:

A. The President and chief executive officer of Lum's Inc. is a Defendant in this action. The Directors cannot be expected to cause the corporation to sue its chief executive officer.

B. Defendant, Chasen, dominates and controls Lum's, Inc.'s Board of Directors. If Lum's, Inc. brought this action, the conduct of the suit would be under the control of its Directors who, in turn, are controlled by Defendant, Chasen. Thus, Defendant, Chasen, would be in charge of a lawsuit against himself.

24. A demand upon the shareholders of Lum's, Inc. to commence this action would be a useless act because:

A. The wrong alleged herein constitutes a waste of Lum's, Inc.'s assets for the benefit of the Defendants and cannot be ratified or approved except by the unanimous action of all of Lum's, Inc.'s shareholders.

B. Under the laws of Florida and the charter and by-laws of Lum's, Inc., the management of its affairs, including the institution of all actions on its behalf, rests on the Board of Directors and not on the stockholders.

C. Any stockholder resolution to bring such a suit would be futile, since control of the action would be in the hands of the wrongdoers and could not be properly prosecuted.

D. Such a demand would cause an unconscionable burden on Plaintiff, in that proxies would have to be solicited for the many thousands of Lum's, Inc. shareholders who reside in many states of the union and in foreign countries.

E. Such a demand would result in undue delay, prejudicial to Plaintiff and Lum's, Inc., and would create the danger of barring the claim alleged herein through the statute of limitations and laches.

25. Plaintiff has no adequate remedy at law.

Pleadings

Amended Complaint in Gregorio v. *Lum's, Inc., No. 71 Civ. 1925*

Relief Requested

WHEREFORE, Plaintiff, Antone F. Gregorio, prays for judgment, as follows:

1. Requiring Defendants to account to Lum's, Inc. for the profits made by Defendants, Dimensions Fund and Variable Fund;

2. Assessing punitive damages against Defendants in the amount of $1,000,000;

3. Awarding Plaintiff the costs and expenses of this action, including a reasonable attorney's fee; and

4. Such other and further relief as to this Court may be just and proper.

/s/ EDWARD A. BERMAN
Edward A. Berman,
One of Plaintiffs' Attorneys

LEWIS W. SCHLIFKIN, ESQ.
EDWARD A. BERMAN, ESQ.
134 North LaSalle Street
Chicago, Illinois 60602
ST 2-9120

DEMAND FOR JURY TRIAL

Plaintiffs hereby respectfully demand trial by jury.

/s/ EDWARD A. BERMAN
Edward A. Berman,
One of Plaintiffs' Attorneys

Notice of Motion and Affidavit of Benjamin Simon in Support of Motion to Dismiss the Complaint in No. 71 Civ. 4218

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

71 Civ. 4218 HRT

JACOB SCHEIN and MARVIN H. SCHEIN,
Plaintiffs,

against

MELVIN CHASEN, *et al.*,
Defendants.

SIRS:

PLEASE TAKE NOTICE that upon the complaint, the annexed affidavit of Benjamin N. Simon sworn to October 11, 1971 and upon all prior proceedings herein, the undersigned will move before the Honorable Harold R. Tyler on October 22, 1971 at 10:00 A.M., or as soon thereafter as counsel can be heard, in Room 2704 of the United States Courthouse, Foley Square, New York, for an order pursuant to Rule 12 FRCP dismissing this action for lack of personal jurisdiction over defendant Simon and for failure to state a claim upon which relief can be granted, or, in the alternative, for summary judgment in favor of defendant Simon under Rule

56 FRCP, and for such other and further relief as to the court may appear just.

Dated: New York, New York
October 12, 1971

WHITE & CASE

By /s/ DAVID HARTFIELD, JR.
A Member of the Firm
Attorney for Defendant Benjamin Simon
14 Wall Street
New York, New York

To:

SIMPSON, THACHER & BARTLETT
Attorneys for defendant
Lehman Brothers
1 Battery Park Plaza
New York, New York 10004

DONOVAN, LEISURE, NEWTON & IRVINE
Attorneys for defendants
Investors Diversified Services, Inc.
IDS New Dimensions Fund, Inc.,
Investors Variable Payment Fund, Inc.
Eugene C. Sit and James R. Jundt
2 Wall Street
New York, New York 10005

Notice of Motion and Affidavit of Benjamin Simon in Support of Motion to Dismiss the Complaint in No. 71 Civ. 4218

ROYALL, KOEGEL & WELLS
Attorneys for defendants
Melvin Chasen and Lum's, Inc.
200 Park Avenue
New York, New York 10017

WOLF, POPPER, ROSS, WOLF & JONES
Attorneys for Plaintiffs
845 Third Avenue
New York, New York 10022

Notice of Motion and Affidavit of Benjamin Simon in Support of Motion to Dismiss the Complaint in No. 71 Civ. 4218

(Caption Omitted in Printing)

AFFIDAVIT

STATE OF ILLINOIS }
COUNTY OF COOK } ss.:

BENJAMIN N. SIMON, being sworn says:

1. I am a defendant in this action, *Schein* v. *Chasen, et al.*, and make this affidavit in support of the within motion to dismiss this action under Rule 12 FRCP for lack of personal jurisdiction and for failure to state a claim or for summary judgment under Rule 56 FRCP.

2. I was personally served with the complaint in this action by a United States Marshal in Chicago, Illinois on September 28, 1971. I live and work in Chicago, where I am employed by Lehman Brothers as an institutional securities salesman. I was living in Chicago, and worked in Lehman Brothers' Chicago office, during the week of January 5, 1970, when the events described in the complaint allegedly took place. Specifically, I was in Chicago on January 8, 1970, when I understand the complaint charges that I received material information from Melvin Chasen of Lum's, Inc. and transmitted such information to Eugene Sit of Investors Diversified Services, Inc. ("IDS"). I did have telephone conversations with Mr. Chasen on January 8, 1970, and with Mr. Sit on January 8 or 9, 1970. Mr. Chasen was in Miami at the time, where Lum's has its principal place of business. Mr. Sit was in Minneapolis,

where IDS is located. I did not receive from Mr. Chasen or transmit to Mr. Sit any material non-public information on January 8 or 9, 1970 or at any other time.

3. My attorneys advise me that the complaint in this action charges that either I or Lehman Brothers profited in some way from the sale by IDS on January 9, 1970 of its 83,000 shares of Lum's common stock. This is not the case. IDS did not sell the 83,000 shares of Lum's through Lehman Brothers and neither Lehman Brothers nor I received any commission or other benefit from the transaction. Neither I nor any member of my family bought or sold any Lum's stock during the period in question.

/s/ BENJAMIN N. SIMON

(Jurat Omitted in Printing)

Notice of Motion of Investors Diversified Services, Inc., *et al.*, to Dismiss the Complaints in Nos. 70 Civ. 5733, 71 Civ. 1925 and 71 Civ. 4218

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

70 Civil 5733 HRT

JOSEPH GILDENHORN, as Custodian for CAROL ANN GILDENHORN,

Plaintiff,

against

LUM'S, INC., *et al.*,

Defendants.

71 Civil 1925 HRT

ANTONE F. GREGORIO,

Plaintiff,

against

LUM'S, INC., *et al.*,

Defendants.

71 Civil 4218 HRT

JACOB SCHEIN and MARVIN H. SCHEIN,

Plaintiffs,

against

MELVIN CHASEN, *et al.*,

Defendants.

SIRS:

PLEASE TAKE NOTICE that the undersigned will move before the Honorable Harold R. Tyler, Jr. on October 22,

Notice of Motion of Investors Diversified Services, Inc., et al., to Dismiss the Complaints in Nos. 70 Civ. 5733, 71 Civ. 1925 and 71 Civ. 4218

1971 at 10:00 A.M., or as soon thereafter as counsel can be heard, in Room 2704 of the United States Courthouse, Foley Square, New York, for an order pursuant to Rules 4(e) and 12(b)(2) and (6) of the Federal Rules of Civil Procedure (1) dismissing the complaints and the amended complaint in the above entitled actions as to Investors Diversified Services, Inc., IDS New Dimensions Fund, Inc., Investors Variable Payment Fund, Inc., Eugene C. Sit and James R. Jundt, upon the ground that said complaints and amended complaint fail to state a claim upon which relief can be granted, or, in the alternative, staying said actions pending a final determination in *Sanders* v. *Lum's, Inc., et al.*, 70 Civ. 5331 HRT and (2) dismissing said complaint and amended complaint as to Eugene C. Sit and James R. Jundt, upon the ground of lack of jurisdiction over the person.

Dated: New York, New York
October 12, 1971

DONOVAN LEISURE NEWTON & IRVINE

By /s/ ROGER V. PUGH, JR.
A Member of the Firm
Attorneys for Defendants
Investors Diversified Services, Inc.
IDS New Dimensions Fund, Inc.
Investors Variable Payment Fund, Inc.
Eugene C. Sit and James R. Jundt

To:

SIDNEY B. SILVERMAN, ESQ.
Attorney for Joseph Gildenhorn,
or Custodian for Carol Ann Gildenhorn
233 Broadway
New York, N. Y. 10007

Notice of Motion of Investors Diversified Services, Inc., et al., to Dismiss the Complaints in Nos. 70 Civ. 5733, 71 Civ. 1925 and 71 Civ. 4218

LEWIS W. SCHLIFKIN, ESQ.
EDWARD A. BERMAN, ESQ.
Attorneys for Antone F. Gregorio
134 North La Salle Street
Chicago, Illinois 60602

WOLF POPPER ROSS WOLF & JONES
Attorneys for Jacob Schein and
Marvin H. Schein
845 Third Avenue
New York, N. Y. 10022

WHITE & CASE
Attorneys for Benjamin Simon
14 Wall Street
New York, N. Y. 10005

SIMPSON THACHER & BARTLETT
Attorneys for Lehman Brothers
One Battery Park Plaza
New York, N. Y. 10004

ROYALL KOEGEL & WELLS
Attorneys for Lum's, Inc.
and Melvin Chasen
200 Park Avenue
New York, N. Y. 10017

Notice of Motion and Affidavit of Herbert A. Lisle in Support of Motion of Defendant Lehman Brothers to Dismiss the Complaints in Nos. 70 Civ. 5733, 71 Civ. 1925 and 71 Civ. 4218

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

70 Civil 5733

JOSEPH GILDENHORN, as Custodian for CAROL ANN GILDENHORN, *Plaintiff,*

against

LUM'S, INC., *et al.*, *Defendants.*

71 Civil 1925

ANTONE F. GREGORIO, *Plaintiff,*

against

LUM'S, INC., *et al.*, *Defendants.*

71 Civil 4218

JACOB SCHEIN and MARVIN H. SCHEIN, *Plaintiffs,*

against

MELVIN CHASEN, *et al.*, *Defendants.*

SIRS:

PLEASE TAKE NOTICE that upon the complaint, the annexed affidavit of Herbert A. Lisle, sworn to October 13, 1971 and

Notice of Motion and Affidavit of Herbert A. Lisle in Support of Motion of Defendant Lehman Brothers to Dismiss the Complaints in Nos. 70 Civ. 5733, 71 Civ. 1925 and 71 Civ. 4218

upon all prior proceedings herein, the undersigned will move before the Hon. Harold R. Tyler on October 22, 1971 at 10:00 A.M., or as soon thereafter as counsel can be heard, in Room 2704 of the United States Courthouse, Foley Square, New York, for an order pursuant to Rule 12 of the Federal Rules of Civil Procedure dismissing the complaints in the above-entitled actions as to defendant Lehman Brothers upon the ground that said complaints fail to state a claim upon which relief can be granted, or, in the alternative, staying said action pending a final determination in *Sanders* v. *Lum's, Inc., et al.*, 70 Civ. 5331 HRT.

Dated: New York, New York
October 13, 1971

SIMPSON THACHER & BARTLETT
By /s/ JAMES J. HAGAN
A Member of the Firm
Attorneys for Defendant
Lehman Brothers
One Battery Park Plaza
New York, New York 10004

To:

SIDNEY B. SILVERMAN, ESQ.
Attorney for Plaintiff Joseph Gildenhorn, as Custodian for Carol Ann Gildenhorn
233 Broadway
New York, New York 10007

Notice of Motion and Affidavit of Herbert A. Lisle in Support of Motion of Defendant Lehman Brothers to Dismiss the Complaints in Nos. 70 Civ. 5733, 71 Civ. 1925 and 71 Civ. 4218

LEWIS W. SCHLIFKIN, ESQ.
EDWARD A. BERMAN, ESQ.
Attorneys for Plaintiff Antone F. Gregorio
134 North LaSalle Street
Chicago, Illinois 60602

WOLF POPPER ROSS WOLF & JONES
Attorneys for Plaintiffs Jacob Schein and Marvin H. Schein
845 Third Avenue
New York, New York 10022

DONOVAN LEISURE NEWTON & IRVINE
Attorneys for Defendants
Investors Diversified Services, Inc.,
IDS New Dimensions Fund, Inc.,
Investors Variable Payment Fund, Inc.,
Eugene C. Sit and James R. Jundt
Two Wall Street
New York, New York 10005

WHITE & CASE
Attorneys for Defendant Benjamin Simon
14 Wall Street
New York, New York 10005

ROYALL KOEGEL & WELLS
Attorneys for Defendants Lum's, Inc. and Melvin Chasen
200 Park Avenue
New York, New York 10017

Notice of Motion and Affidavit of Herbert A. Lisle in Support of Motion of Defendant Lehman Brothers to Dismiss the Complaints in Nos. 70 Civ. 5733, 71 Civ. 1925 and 71 Civ. 4218

(Caption Omitted in Printing)

AFFIDAVIT

STATE OF NEW YORK }
COUNTY OF NEW YORK } ss.:

HERBERT A. LISLE, being duly sworn, deposes and says:

1. I am a member of the firm of Lehman Brothers, one of the defendants in the above-entitled actions. I make this affidavit in support of the motion by said defendant for an order dismissing these actions for failure to state a claim upon which relief can be granted.

2. I am informed that the complaints in these actions charge that on January 8, 1970, Benjamin Simon, a salesman in Lehman Brothers' Chicago office received material information from Melvin Chasen of Lum's, Inc. and transmitted such information to Eugene Sit of Investors Diversified Services, Inc. and that Lehman Brothers profited in some way from the sale by Investors Diversified Services on January 9, 1970 of its 83,000 shares of Lum's common stock. This is not the case. Investors Diversified Services did not sell the 83,000 shares of Lum's through Lehman Brothers and Lehman Brothers did not receive any commission or other benefit from the transaction. Accordingly, I respectfully request that the present motion be granted in all respects.

/s/ HEBRERT A. LISLE

(Jurat Omitted in Printing)

Notice of Joinder in Motion and Affidavit of Melvin Chasen in Support of Motion to Dismiss the Complaints in Nos. 70 Civ. 5733, 71 Civ. 1925, and 71 Civ. 4218

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

70 Civil 5733

JOSEPH GILDENHORN, as Custodian for CAROL ANN GILDENHORN, *Plaintiff,*

against

LUM'S, INC., *et al.*, *Defendants.*

71 Civil 1925

ANTONE F. GREGORIO, *Plaintiff,*

against

LUM'S, INC., *et al.*, *Defendants.*

71 Civil 4218

JACOB SCHEIN and MARVIN H. SCHEIN, *Plaintiffs,*

against

MELVIN CHASEN, *et al.*, *Defendants.*

SIRS:

PLEASE TAKE NOTICE that defendant MELVIN CHASEN, by the undersigned, will join in the motion to be made on

Notice of Joinder in Motion and Affidavit of Melvin Chasen in support of Motion to Dismiss the Complaints in Nos. 70 Civ. 5733, 71 Civ. 1925 and 71 Civ. 2418

behalf of defendants Investors Diversified Services, Inc., IDS New Dimensions Fund, Inc., Investors Variable Payment Fund, Inc., Eugene C. Sit, James R. Jundt and Benjamin Simon to dismiss the complaints in the above action before the Honorable Harold R. Tyler, Jr., United States District Judge, Room 2704, United States Court House. Foley Square, New York, New York, on October 22, 1971, at 2:15 P.M., or as soon thereafter as counsel can be heard, in accordance with the Notices of Motion dated October 12, 1971, subscribed by counsel for the above listed defendants.

Dated: New York, New York
October 18, 1971

Yours, etc.

ROYALL KOEGEL & WELLS
By /s/ GUY C. QUINLAN
A Member of the Firm
Attorneys for Defendant Melvin Chasen
200 Park Avenue
New York, New York 10017
Telephone: 972-7000

To:

SIDNEY B. SILVERMAN, ESQ.
Attorney for Joseph Gildenhorn, as Custodian for Carol Ann Gildenhorn
233 Broadway
New York, New York 10007

Notice of Joinder in Motion and Affidavit of Melvin Chasen in support of Motion to Dismiss the Complaints in Nos. 70 Civ. 5733, 71 Civ. 1925 and 71 Civ. 2418

LEWIS W. SCHLIFKIN, ESQ.
EDWARD A. BERMAN, ESQ.
Attorneys for Antone F. Gregorio
134 North La Salle Street
Chicago, Illinois 60602

WOLF POPPER ROSS WOLF & JONES
Attorneys for Jacob Schein and Marvin H. Schein
845 Third Avenue
New York, New York 10022

WHITE & CASE
Attorneys for Benjamin Simon
14 Wall Street
New York, New York 10005

SIMPSON THACHER & BARTLETT
Attorneys for Lehman Brothers
One Battery Park Plaza
New York, New York 10004

DONOVAN LEISURE NEWTON & IRVINE
Attorneys for Defendants
Investors Diversified Services, Inc., IDS New Dimensions Fund, Inc., Investors Variable Payment Fund, Inc., Eugene C. Sit and James R. Jundt
Two Wall Street
New York, New York 10005

Notice of Joinder in Motion and Affidavit of Melvin Chasen in support of Motion to Dismiss the Complaints in Nos. 70 Civ. 5733, 71 Civ. 1925 and 71 Civ. 2418

(Caption Omitted in Printing)

AFFIDAVIT IN SUPPORT OF MOTION TO DISMISS

STATE OF FLORIDA }
COUNTY OF DADE } ss.:

MELVIN CHASEN, being duly sworn, deposes and says:

1. I am one of the defendants named in each of the above-entitled actions, and am the President of defendant Lum's, Inc. I make this affidavit in support of the motion by certain defendants to dismiss the above actions for failure to state a claim upon which relief can be granted, and as to the individual defendants for lack of personal jurisdiction.

2. I am, and have been at all times referred to in the complaint, a citizen of the State of Florida. I reside at 2085 N.E. 120th Road, North Miami, Florida, and maintain my office at 8515 Biscayne Boulevard, Miami, Florida. I do not maintain, and I have not maintained at any time referred to in the complaints herein either a place of business or a residence in the State of New York. I was not personally served in any of the above actions in the State of New York. Purported service was made on me in the State of Florida.

3. I am informed and believe that the basis of the purported claim in these actions relates to alleged telephone conversations between myself and Benjamin Simon on January 8, 1970. I do not admit the truth of plaintiffs' allegations as to the content of such conversations, and if this

action is tried the evidence will show that I was not guilty of any improper or unlawful act. However, I believe it is undisputed that the only telephone conversations I had with Mr. Simon on the dates in question were between my office in Miami, Florida, and Mr. Simon's office in Chicago, Illinois.

4. I did not, at any time referred to in the complaints herein, buy or sell any stock of defendant Lum's, Inc. No member of my family, and no company in which I hold any interest, bought or sold Lum's stock at such time. I am advised that there is no allegation that I individually profited as a result of any of the matters alleged in the complaints, and in fact I did not profit with respect to any of the alleged matters or transactions referred to.

WHEREFORE, I respectfully request that the motions to dismiss be granted.

/s/ MELVIN CHASEN

(Jurat Omitted in Printing)

Opinion of the District Court
Dated December 15, 1971

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

Nos. 70 Civ. 5733, 71 Civ. 1925 and 4218

JOSEPH GILDENHORN, as Guardian for Carol Ann Gildenhorn,

Plaintiff,

v.

LUM'S INC., *et al.*,

Defendants.

ANTONE F. GREGORIO,

Plaintiff,

v.

LUM'S INC., *et al.*,

Defendants.

JACOB SCHEIN and MARVIN H. SCHEIN,

Plaintiffs,

v.

MELVIN CHASEN *et al.*,

Defendants.

December 15, 1971.

TYLER, *District Judge*

Defendants in these consolidated actions have moved to dismiss plaintiffs' complaints upon the ground that they fail to state a claim upon which relief can be granted. Rule 12(b) (6) F.R. Civ.P. Alternatively, all defendants move this court to stay these actions pending a final determina-

tion in *Sanders* v. *Lum's Inc. et al.*, 70 Civ. 5331, a related action pending before this court. Additionally, the individual defendants move that the complaints be dismissed as against them upon the ground that jurisdiction over their persons has not been obtained. Rules 4(e) and 12(b)(2), F.R.Civ.P.[1]

All three of these suits are derivative actions brought on behalf of Lum's Inc. ("Lum's"), a Florida corporation. Jurisdiction is claimed by virtue of diversity of citizenship. The plaintiffs' complaints are predicated on the same facts as *S.E.C.* v. *Lum's et al.*, 70 Civ. 5280, which is also pending before this court. Briefly stated, plaintiffs' claims are based on defendants' alleged misuse of confidential corporate information. The complaints charge that defendant Melvin E. Chasen, aware as president of Lum's that the firm's 1969 earnings would be lower than had been projected, telephoned from his Florida office to defendant Simon, who is employed in the Chicago, Illinois office of defendant Lehman Brothers, Inc., and told him of the earnings' decline. Simon then transmitted the information to Sit, the portfolio manager at defendant IDS New Dimensions Fund ("Dimensions"), whose offices are in Minneapolis, Minnesota. Sit then conveyed the information to defendant Jundt, a manager and analyst for IDS Variable Payment Fund ("Variable"). It is further alleged that Sit and Jundt then caused Variable and Dimensions to sell their entire holdings in Lum's just before the public announcement of the decline in the 1969 earnings caused the stock to drop several points .n trading on the New York Stock Exchange.

1. Defendants Sit and Jundt, apparently unaware that I have already granted their prior motions to dismiss by order dated October 25 of this year, once again seek the same relief. As they are no longer defendants in any of these actions, their applications will not be considered.

Opinion of the District Court
Dated December 15, 1971

Plaintiffs make no argument that any of the federal securities acts would support a claim under the facts of this case. They do argue, however, that a claim for which relief can be granted can be made out under the recent decision of the New York Court of Appeals in *Diamond* v. *Oreamuno,* 24 N.Y.2d 494, 301 N.Y.S.2d 78, 248 N.E.2d 910 (1969). Briefly stated, that case held that corporate officers who learn of a drop in corporate earnings by virtue of their fiduciary positions and sell their shares of corporate stock before publishing information as to the loss will be liable to the corporation for any profits made thereby. Plaintiffs urge that Chasen be found liable under *Diamond* even though it is not alleged that he sold any Lum's stock belonging to him and that the remaining defendants be so held under either a "tippee" or general conspiracy theory.

Three issues, thus, are presented to this court by these motions, the first being a choice of law problem. The defendants argue that under the applicable choice of law provisions, these cases should be decided by Florida law. Plaintiffs oppose and urge that their complaints be tested by New York law in general and by *Diamond* v. *Oreamuno, supra,* in particular. Assuming that *Diamond* would apply, this court would then have to determine whether the complaints herein can state a claim under the holding of that case. Finally, it must be decided whether the activities of the individual defendants fall within any of the provisions of the New York long-arm statute, CPLR § 302(a), so as to allow out of state service to be effected upon them pursuant to CPLR § 313.

In actions where jurisdiction is predicated on diversity of citizenship, this court must apply the choice of law rules of the State of New York. *Klaxon Co.* v. *Stentor Electric Mfg. Co.,* 313 U. S. 487, 61 S.Ct. 1020, 85 L.Ed. 1477 (1941). New York follows the general choice of law principle that the law of the state of incorporation governs the existence

and extent of corporate fiduciary obligations as well as the liability for violations of such obligations. *Hausman* v. *Buckley*, 299 F.2d 696, 703 (2d Cir., 1962) and cases cited therein; *Norte & Co.* v. *Huffines*, 304 F.Supp. 1096, 1110 n.6 (S.D.N.Y., 1968). This rule was expressed in *Diamond* itself when the court stated that as regards the ". . . duties and obligations of directors and officers and their relation to the corporation and its shareholders . . . [t]he primary source of the law in this area ever remains that of the State which created the corporation." *Diamond* v. *Oreamuno, supra*, at 503, 504, 301 N.Y.S.2d at 85, 248 N.E.2d at 915.

The same result would be reached by the "grouping of contacts" approach to choice of law in tort actions as enunciated in *Babcock* v. *Jackson*, 12 N.Y.2d 473, 240 N.Y.S.2d 743, 191 N.E.2d 279 (1963). Under this approach, a New York court will apply the law of the state of the "strongest contacts with the cause of action." *Stockwell* v. *Reynolds & Co.*, 252 F.Supp. 215, 220 n.3 (S. D.N.Y., 1965). It appears from the pleadings that this case centers in Florida rather than in New York. Chasen, a Florida citizen, allegedly received and communicated the information from Florida. Lum's was incorporated, headquartered, and, at least theoretically, damaged in Florida. Most of the other contacts appear to be scattered about the midwest, the only contact with New York being several transactions over the New York Stock Exchange. Additionally, a New York court would give more weight to the Florida contacts under the "governmental interest" theory of choice of law enunciated in *Tooker* v. *Lopez*, 24 N.Y.2d 569, 301 N.Y.S.2d 519, 249 N.E.2d 394 (1969), because Florida has the paramount interest in defining and enforcing fiduciary obligations owing to corporations incorporated and doing business within its borders. Accord-

ingly, I find that under any conceivable test, a New York court would apply Florida law to this case.

Under present Florida case law, a plaintiff in a derivative action must prove that the corporation has been damaged by the alleged breach of fiduciary trust. Although the highest court in that state has apparently not considered the matter, several District Courts of Appeal have held on various occasions that a complaint which fails ". . . to indicate both wrongful acts and damage to the corporation" must be dismissed. *Palma* v. *Zerbey,* 189 So. 2d 510, 511 (Fla.App., 1966), cert. denied 200 So.2d 814. (and cases cited therein.)

While it is apparently required that the damage to a corporation be alleged, the Florida cases shed no light on the specificity required for pleading corporate damage. Thus, though the Gildenhorn and Gregorio complaints might be insufficient under Florida law for failing to allege any damage to the corporation at all, the Schein complaint, which contains only a bare allegation that Lum's was damaged, might conceivably be held to be sufficient by a Florida court. Furthermore, I am not unmindful of the possibility that, were a Florida court to hear this case, *Diamond* v. *Oreamuno, supra.,* would be argued to it. Because of the possibility that the *Diamond* rationale might be followed in Florida, it is desirable that this court determine whether these complaints state a claim under *Diamond* for which relief can be granted.

It is clear that the complaints in these actions go far beyond the narrow holding of *Diamond.* In that case, the New York Court of Appeals held that a corporate fiduciary is liable for profits which he realizes from a sale of stock motivated by inside information received by him in his corporate position. None of the defendants in these actions fit into this mold. Chasen, as president and chief operating officer of Lum's, was certainly a fiduciary of that corpo-

ration. None of the complaints, however, allege that he did anything more than pass the inside information to defendant Simon, and there are no allegations that Chasen sold any of his Lum's stock or derived any gain, monetary or otherwise, from the sales that ultimately occurred. On the other hand, the mutual fund defendants would have profited if, as alleged, they sold their 83,000 shares of Lum's stock on the basis of Chasen's inside information. It can scarcely be maintained, however, that the mutual fund defendants were officers or directors of Lum's or owed any fiduciary duties whatsoever to that corporation. The broker-dealer defendants fail to come within either of the *Diamond* perimeters as they were not fiduciaries of the corporation and, did not profit by virtue of the sales.

Plaintiffs, of course, urge a more expansive view of *Diamond*. They point to portions of the opinion indicating that the purpose of the holding was to protect the corporation's interest in ". . . maintaining a reputation of integrity, an image of probity, for its management and in insuring the continued public acceptance and marketability of its stock." *Diamond* v. *Oreamuno, supra,* at 499, 301 N.Y.S.2d at 82, 248 N.E.2d at 912. Thus, say plaintiffs, if the purpose of *Diamond* is to maintain a corporation's integrity on the securities exchanges, it should make no difference whether an officer or director sells his own stock or passes the inside information to others who in turn sell their stock and profit thereby. While the harm done to the corporation might be equal in either instance, there is evidence that *Diamond* was not intended to cover the latter situation. As Chief Judge Fuld explained, the purpose of that derivative action was to allow individual shareholders to be ". . . 'private Attorney General[s]' to . . . enforce proper behavior on the part of corporate officials." *Diamond* v. *Oreamuno, supra,* at 503, 301 N.Y.S.2d at 85, 248

N.E.2d at 915. It is implicit that the jurisdiction of these "private attorney generals" would be limited to the corporation in which they are shareholders. It could not, with any logic, be extended in a derivative action to cover outside individuals, corporations, or institutions who are subject to other private and governmental restraints on their behavior. Furthermore, in affirming the dismissal of the *Diamond* complaint against other board members who were alleged to have aided the defendants in concealing their activities, the New York Court of Appeals made it quite clear that *Diamond* extends only to corporate fiduciaries who actually profit by inside information and does not cover aiders and abettors and/or conspirators. In view of the fact that the New York Court of Appeals could not bring itself to find liability for inter-corporate conspirators, I fail to perceive how this court could extend *Diamond* to cover extra-corporate conspirators and tippees. Accordingly, I conclude that with regard to all defendants save Chasen, the complaints herein fail to state a claim for which relief can be granted.

On the other hand, Chasen, as a corporate officer, might well come within the *Diamond* holding. Although it could be plausibly argued that *Diamond* would not apply to Chasen because of the failure to allege that he sold any stock and profited thereby, it might also be maintained that a New York court could find liability in light of the numerous statements in *Diamond* to the effect that the purpose of the holding is to prevent corporate misfeasance. This question, however, need not be reached because service of process upon Chasen was improper.

In diversity actions, this court's jurisdiction is determined by the law of the State of New York. Rule 4(d)(7), F.R.Civ.P. Because Chasen is not a New York resident and was not served in New York, jurisdiction of his person depends on the New York long-arm statute, CPLR

§ 302(a). It is plaintiffs' assertion that jurisdiction was obtained over Chasen because he set in motion events which culminated with the alleged sale of 83,000 shares of Lum's stock over an exchange located in New York. While I am aware that the scope of CPLR § 302(a) has been broadly construed, I fail to see how it can be read to cover the facts in this case.

While it is settled that one can "transact business" within the meaning of CPLR § 302(a) (1) through an agent, *Parke-Bernet Galleries, Inc.* v. *Franklyn,* 26 N.Y.2d 13, 308 N.Y.S.2d 337, 256 N.E.2d 506 (1970), a New York court would decline jurisdiction of a defendant who merely telephones a single order from outside the state. *Katz & Son Billiard Prods.* v. *Correale & Sons,* 20 N.Y.2d 903, 285 N.Y.S.2d 871, 232 N.E.2d 864 (1967). It seems obvious that Chasen, who did not place the order to sell the Lum's stock in question, did not "purposefully" avail himself "of the privilege of conducting activities" within New York, thereby "invoking the benefits and protections of its laws." *Hanson* v. *Denckla,* 357 U.S. 235, 253, 78 S.Ct. 1228, 1240, 2 L.Ed.2d 1283 (1958).

Plaintiffs next argue that the sale of stock over a national exchange in New York was a "tortious act within the state" and that jurisdiction could be found under CPLR § 302(a) (2). While such a sale will confer jurisdiction in some cases, *Cooper* v. *North Jersey Trust Co. of Ridgewood, New Jersey,* 250 F.Supp. 237 (S.D.N.Y., 1965), CPLR § 302(a) (2) can apply only where the non-resident defendant committed the tort in New York. That the alleged tort here may have been completed or "came to rest" in New York will not confer jurisdiction unless the acts or omissions complained of also occurred in New York. *Feathers* v. *McLucas,* 15 N.Y.2d 443, 261 N.Y.S.2d 8, 209 N.E.2d 68 (1965). *Cooper* v. *North Jersey Trust Co. etc.,*

supra, is not inconsistent as the defendants in that case were physically in New York when they allegedly committed the tort there in issue. As it is nowhere alleged that Chasen committed a tortious act in New York, no jurisdiction of his person can be claimed under CPLR § 302(a) (2).

Finally, there can be no jurisdiction under CPLR § 302(a) (3). As the statute clearly states, the tortious act must cause injury to persons or property in New York. Insofar as none of the non-resident plaintiffs in these cases have alleged that any injury occurred in New York, their invocation of this provision is futile.

Defendant Chasen's motion to dismiss is granted on the ground that no jurisdiction was ever obtained of his person. Rule 12(b) (2) F.R.Civ.P. The motions of the remaining defendants to dismiss under Rule 12(b) (6) F.R.Civ.P. are hereby granted. In view of these rulings, defendants' alternative motion for a stay of these actions need not be reached.

Settle orders accordingly.

Judgment of the District Court

Dated January 5, 1972

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

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70 Civil 5733 HRT

JOSEPH GILDENHORN, as Custodian for CAROL ANN GILDENHORN,

Plaintiff,

against

LUM'S INC., *et al.*,

Defendants.

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71 Civil 1925 HRT

ANTONE F. GREGORIO,

Plaintiff,

against

LUM'S, INC., *et al.*,

Defendants.

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71 Civil 4218 HRT

JACOB SCHEIN and MARVIN H. SCHEIN,

Plaintiff,

against

MELVIN CHASEN, *et al.*,

Defendants.

Defendants Investors Diversified Services, Inc., IDS New Dimensions Fund, Inc., and Investors Variable Payment

Judgment of the District Court
Dated January 5, 1972

Fund, Inc., having moved to dismiss the complaints and the amended complaint in the above entitled actions under Rule 12(b) of the Federal Rules of Civil Procedure and the defendants Benjamin Simon, Lehman Brothers, Lum's, Inc., and Melvin Chasen having joined in said motion and said motions having come on to be heard before the Honorable Harold R. Tyler, United States District Judge, on November 19, 1971, and the Court having considered the papers submitted on said motions, having heard argument of counsel, and having issued an Opinion dated December 15, 1971 granting said motions, it is hereby

ORDERED that the above entitled actions be and they hereby are dismissed with prejudice, and without costs.

Dated: New York, New York
January 5, 1972

H. R. TYLER, JR.
U.S.D.J.

Opinions of the Court of Appeals

Dated May 10, 1973

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 81 and 82—September Term, 1972.

(Argued October 17, 1972 Decided May 10, 1973)

Docket Nos. 72-1373, 72-1375

JACOB SCHEIN and MARVIN H. SCHEIN,

Plaintiffs-Appellants,

v.

MELVIN CHASEN, INVESTORS DIVERSIFIED SERVICES, INC., LEHMAN BROTHERS, INVESTORS VARIABLE PAYMENT FUND, INC., BENJAMIN SIMON, IDS NEW DIMENSIONS FUND, INC., EUGENE S. SIT, JAMES R. JUNDT, and LUM'S, INC.,

Defendants-Appellees.

ANTONE F. GREGORIO, individually and as representative of all persons similarly situated as a class under Rule 23, F.R.C.P.,

Plaintiff-Appellant,

v.

LUM'S, INC., MELVIN CHASEN, LEHMAN BROTHERS, BENJAMIN SIMON, INVESTORS DIVERSIFIED SERVICES, INC., EUGENE S. SIT, and JAMES R. JUNDT,

Defendants-Appellees.

Before:

WATERMAN, SMITH and KAUFMAN,

Circuit Judges.

Opinions of the Court of Appeals
Dated May 10, 1973

Invoking the diversity jurisdiction of the court, plaintiffs in three cases consolidated below sued derivatively in United States District Court for the Southern District of New York, Tyler, *J.*, alleging that defendants were jointly and severally liable under state corporation law for the profits realized by the defendants Mutual Funds through their trading on the New York Stock Exchange in derivative defendant's stock on the basis of non-public material inside information. An order granting summary judgment was granted to defendants and in two of the consolidated actions the parties have argued appeals.

Reversed and remanded for further proceedings consistent with this opinion.

WATERMAN, *Circuit Judge:*

Plaintiffs-appellants are stockholders in Lum's, Inc., a Florida corporation primarily engaged in restaurant franchising. Invoking the diversity jurisdiction of the court, they sued derivatively in the Southern District of New York alleging that the defendants were jointly and severally liable to Lum's for actionable wrongs which the defendants had committed against Lum's. The individual defendants were Melvin Chasen, a resident of Florida, president of Lum's, Benjamin Simon, a stockbroker employed in Chicago, Ill. by defendant Lehman Brothers, Eugene S. Sit, portfolio manager of defendant IDS New Dimensions Fund, Inc., a Mutual Fund, and James R. Jundt, manager of defendant Investors Variable Payment Fund., Inc., a Mutual Fund. Each of the four individual defendants moved for dismissal on the ground that they had not been validly served under the New York Long Arm Statute (CPLR §§ 313, 302(a)) and that the court below had no personal jurisdiction of them. Sit's and Jundt's motions were granted prior to the filing of the

order appealed from, Chasen's was granted concurrently therewith, and Simon's has apparently not been acted upon.[1] The defendants Lehman Brothers, a partnership engaged in stock brokerage and investment counseling, the three corporations, engaged in managing investment portfolios and in buying and selling the corporate securities of publicly held corporations, Chasen, and Simon, all moved for dismissal on the ground that the complaints failed to state a cause of action under Florida law. Plaintiffs claimed that New York law should govern the rights and liabilities of the parties, and that even if Florida law were the applicable law they should still prevail. Holding that Florida law was the proper state law to apply, Judge Harold R. Tyler, Jr., by written order, *sub nom Gildenhorn* v. *Lum's, Inc.*, opinion reported at 335 F.Supp. 329 (SDNY 1971), granted the motion to dismiss for failure to state a claim upon which relief could be granted.

On this appeal plaintiffs claim only that Judge Tyler erred in dismissing the complaints for failure to state a cause of action.[2] They do not appeal Judge Tyler's order dismissing Chasen as a defendant or his finding that the substantive law of Florida governs the action.[3] Inasmuch

[1] Plaintiffs-appellants have not appealed the order dismissing the actions against Chasen, Sit and Jundt. Simon filed a similar dismissal motion but the trial court did not decide it. Simon was dismissed as a defendant by the court's order dismissing the complaints against all defendants for failure to state a cause of action under 12(b)(6) of the Fed. R. Civ. P. Simon contends on this appeal that irrespective of our action on the lower court's dismissal of the complaints under 12(b)(6), we should dismiss the action against him because he has not been validly served. However, inasmuch as the trial court has not reached this question, we decline to address it on this appeal, and leave its resolution to the trial court upon remand.

[2] In one of the original actions consolidated below, *Gildenhorn* v. *Lum's, Inc.*, 335 F.Supp. 329 (SDNY 1971) a notice of appeal was filed by plaintiff but the parties have not progressed the appeal.

[3] The parties now agree that the substantive law of the State of Florida governs the action for reasons which are stated in Judge Tyler's opinion reported at 335 F.Supp. 329 (SDNY 1971).

as the court is passing only upon the sufficiency of the complaints, we necessarily accept the allegations of the complaints as true. For reasons which follow, we hold that the complaints do state a cause of action and we reverse the judgment below and remand to the district court for further proceedings there in the light of this holding.

The facts alleged in this case fall within the perimeter of the much-discussed problem of unfair trading in corporate securities. In November of 1969 Chasen, who was president and chief operating officer of Lum's addressed a seminar of about sixty members of the securities industry with reference to Lum's earnings prospects for its fiscal year ending July 31, 1970. He informed them that Lum's earnings would be approximately $1.00 to $1.10 per share. On January 5, 1970 he learned that this estimate was too optimistic and that, in fact, Lum's earnings would be only approximately $.76 per share. Three days later, prior to announcing the information to the public, Chasen telephoned Simon in Chicago and told Simon that Lum's would not have as profitable a year as had been expected. He specified to Simon that earnings would be approximately $.76 per share rather than the $1.00 per share which he had earlier announced. Simon knew the information was confidential corporate property which Chasen had not given out publicly. Simon immediately telephoned this information to Sit, an employee of defendant Investors Diversified Services, Inc. (IDS),[4] and Sit immediately telephoned it to Jundt, another employee of IDS. Sit and Jundt managed the stock portfolios of defendant mutual funds Investors Variable Payment Fund, Inc. (Investors) and IDS New Dimensions Fund, Inc. (Dimensions). Upon receiving the

[4] Defendant IDS is a Minnesota corporation licensed to do business in the State of New York. IDS is the distributor and investment advisor for a number of large mutual funds including defendants Investors and Dimensions. Sit and Jundt are employed by IDS to manage the stock portfolios of Investors and Dimensions.

information Sit and Jundt directed the Funds to sell their entire stock holdings in Lum's and, on the morning of January 9, 1970, prior to any public announcement, Investors sold 43,000 shares of Lum's and Dimensions sold 40,000 shares. The sales were executed on the New York Stock Exchange at about 1:30 A.M. at a price of approximately $17.50 per share. At 1:30 P.M. on the same day, the New York Stock Exchange halted further trading in Lum's stock pending a company announcement. At 2:45 P.M. Lum's issued a release which appeared on the Dow Jones News Wire Service and announced that the corporation's projected earnings would be lower than had been anticipated. When trading in Lum's was resumed on Monday, January 12, 1970, volume was heavy and the stock closed at a price of $14.00 per share—$3.50 per share lower than the Funds had realized from the sales of their shares on the previous Friday.

The present defendants in this case are Lehman Brothers, Simon, and the two Mutual Funds. Chasen, Sit, and Jundt have been dismissed as defendants in that they have not been validly served under the New York State Long Arm Statute. Plaintiffs-appellants' theory of recovery is that the participants in this chain of wrongdoing are jointly and severally liable to the corporation under Florida law for misusing corporate information to their own advantage in violation of the duty they owed to Lum's, and that they must account to Lum's for the profits realized by the Mutual Funds. They do not allege in these complaints that defendants have violated any of the federal securities laws,[5] and they concede that the substantive law

[5] Lum's could apparently not prevail as a plaintiff in a Rule 10b-5 action in that it has not traded in its securities on its own account. See *Birnbaum* v. *Newport Steel Corporation*, 193 F.2d 461 (2 Cir. 1952), cert. denied, 343 U.S. 956 (1952). Although there are federal securities law cases pending against defendants in district court, this fact is irrelevant upon the appeal.

of Florida governs the rights and liabilities of the parties. They urge, however, that inasmuch as there are no Florida cases directly in point, the Florida court, if it were deciding the case, would look to other jurisdictions and would take a particular and special interest in the decision of *Diamond* v. *Oreamuno*, 29 A.D.2d 285, 287 N.Y.S.2d 300 (1st Dep't 1968), *aff'd* 24 N.Y.2d 494, 301 N.Y.S.2d 78 (1969), a case which plaintiffs contend supports the position they urge on this appeal.

The first question which our court must consider is whether we may look to the New York decision of *Diamond, supra,* as persuasive authority. Ideally, the federal court sitting in a diversity action applies the applicable state law as it has been enunciated by the highest court in the state. *Erie R. Co.* v. *Tompkins*, 304 U.S. 64 (1938); *Hausman* v. *Buckley*, 299 F.2d 696 (2 Cir. 1962), *cert. denied*, 369 U.S. 885 (1962). However, in the absence of a clearly enunciated state rule, the federal court may turn to the law of other jurisdictions for assistance in determining how the state court would most likely decide the case if the state court were presented with the questions being litigated in the federal court. *Baxter* v. *Lancer Industries, Inc.*, 213 F.Supp. 92 (EDNY 1963), *app. denied*, 324 F.2d 286 (2 Cir. 1963); *Locke Manufacturing Companies* v. *United States*, 237 F.Supp. 80 (D. Conn. 1964). Our foray into the state law of Florida satisfies us that the Florida court has never faced the precise issues which are present in this action. Accordingly, it is both proper and practical for this court to turn for guidance to the body of law of other jurisdictions and particularly to that of New York where the resolution of the issues in the *Diamond* case, decided by the New York Court of Appeals, bears on the issues in the case before us. In doing so, our objective is to interpret *Diamond* as the Florida court would probably interpret it and

to apply *Diamond,* as so interpreted, to the facts presented here.

Diamond v. *Oreamuno, supra,* was a stockholder's derivative action in which a shareholder of Management Assistance, Inc. (MAI) charged that two of the defendants—Oreamuno, chairman of the board of directors, and Gonzales, its president and a member of the board, had used inside information acquired by them solely by virtue of their positions with MAI in order to reap large personal profits from the sale of MAI shares, and that these profits rightfully belonged to the corporation. Chief Judge Stanley Fuld, writing for a unanimous court, held that the two directors must account to the corporation for their profits for they had breached their duty to the corporation by using a corporate asset for their own personal advantage.

In this case we are asked to decide whether the *Diamond* holding should extend to reach third parties who, though not officers or directors of the injured corporation, are involved with directors in a common enterprise to misuse confidential corporate information for their own enrichment. Although there is no allegation in the complaints that a prior explicit agreement existed between Chasen and the defendants, it is obvious that the sequence of events detailed in the pleadings, if proved, will substantiate the existence of a common enterprise pursuant to which Chasen was to pass material information to Simon, Simon was to pass it to the Mutual Funds, and the Funds were to capitalize on it by selling Lum's stock prior to the time the material information was announced to and was available to the public. Cf. *American Tobacco Co.* v. *United States,* 328 U.S. 781 (1946); *Interstate Circuit, Inc.* v. *United States,* 306 U.S. 208 (1939); *Norfolk Monument Company* v. *Woodlawn Memorial Gardens, Inc.,* 394 U.S. 700 (1969). Although defendants do not deny that they have been involved in a joint enterprise with Chasen to misuse corpo-

rate property, they argue that the doctrine of *Diamond* is not applicable here and that they cannot be held liable to Lum's because they are not Lum's fiduciaries and have not breached any duty which they owed to Lum's by cashing in on confidential information for their own advantage. Defendants Simon and Lehman Brothers make the further argument that it would be "unfair" to hold them responsible for the profits made by the Mutual Funds in that they (Simon and Lehman Brothers) did not profit personally inasmuch as neither of them traded in Lum's stock.

As a court of equity viewing the case as the Florida court would probably view it, we cannot agree that the "stretch" of *Diamond* does not reach the defendants in this case. We find nothing in the language of *Diamond* to suggest that co-venturers of the director who breaches his duty should not be subject to the same liabilities as those of the director himself for the misuse of corporate information.[6] Indeed, the general rule has always been that "one who knowingly participates in or joins in an enterprise whereby a violation of a fiduciary obligation is effected is liable jointly and severally with the recreant fiduciary." *Oil & Gas Ventures—First 1958 Fund Ltd.* v. *Kung,* 250 F.Supp. 744 (1966); see, *e.g., Jackson* v. *Smith,* 254 U.S. 586, 589 (1921); *Sexton* v. *Sword S.S. Line Inc.,* 118 F.2d 708, 711 (2 Cir. 1941); *Bankers Life and Casualty Co.* v. *Kirtley,* 338 F.2d 1006, 1013 (8 Cir. 1964). If the *Diamond* court had intended to lay down an exception to this well-

[6] We believe Judge Tyler erred in attaching dispositive significance to the fact that in *Diamond,* supra, the complaint was dismissed against certain directors who had only "acquiesced" in the wrong. The defendants-appellees here differ from the dismissed *Diamond* defendants in that the defendants-appellees were actively engaged in furthering the transaction that resulted in the "dumping" of the Lum's stock, rather than just "acquiescing" in it. Furthermore, and even more importantly, *Diamond* was not a "joint venture" case, and there is no discussion in the *Diamond* opinion as to why the complaint was dismissed against the "acquiescing" directors.

known general rule it could have done so in its opinion. Moreover, in the light of the corporate interest which the *Diamond* rule is designed to protect, it is immaterial to the preservation of that interest whether the director trades on his own account in the corporation's stock or whether he passes on the information to outsiders who then trade in the corporation's stock. In either event, so long as the director is involved, the prestige and good will of the corporation may be tarnished by the public revelation that the director has been involved in unethical conduct. *Diamond, supra* at 499; accord, *S.E.C.* v. *Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1308 (2 Cir. 1971), *cert. denied*, 404 U.S. 1005, *reh. denied*, 404 U.S. 1064 (1972). Accordingly, it would be self-defeating to limit the reach of *Diamond* to directors and officers of the injured corporation who have so acted while permitting third-party co-venturers of theirs to escape liability to the corporation.

Diamond, the law of the jurisdiction in which the New York Stock Exchange is seated, has the prophylactic effect of providing a disincentive to insider trading. It is clear that this cleansing effect ought to reach third parties who, through a breach of a fiduciary relationship, become traders advantageously possessed of confidental insider knowledge. To immunize such third parties from liability to the damaged corporation would encourage insider "leaks" to outside friends and would defeat *Diamond's* purpose and effect. And, quite properly, damages for fiduciary breaches are recoverable by recourse to state law. Indeed, though the congressional policy is similar, in some cases where federal private and governmental Rule 10b-5 actions are impractical, "immunized outsiders" might escape liability altogether except for the availability of this kind of action bottomed upon the well-recognized liability of a fiduciary to those whose trust in the fiduciary has been tragically

misplaced. In view of the strong desirability of tightening the law of insider trading, we would be remiss indeed if we interpreted *Diamond* as narrowly as defendants would have us interpret it. Moreover, sitting as a court of equity, we have here an obligation to determine where the equities lie among all the litigants, *Diamond, supra* at 498, and, as between the defendants and Lum's, there can be no doubt that it would be inequitable to permit the defendants to keep the rewards of the fraud.[7]

Our view that all the participants in the common enterprise must assume the same risks of liability to the corporation as the offending director is supported by Florida case law dealing with the duty of a fiduciary to his cestui. The Florida courts have held that the duty of a fiduciary not to misuse the property of his cestui extends not only to the "technical fiduciary" but also to others who are placed in a position of trust. *Quinn* v. *Phipps*, 93 Fla. 805, 113 So. 419 (1927). The confidential relationship of a fiduciary as that relationship is spelled out in Florida law extends not only to "technical fiduciaries" but also to others who become "fiduciaries" through the acquisition of confidential information which is "owned" by someone else. See *Quinn* v. *Phipps, supra* at 420-421. When the defendants received their "tip" from Chasen, they were automatically clothed with a duty to Lum's not to use the information for their own selfish advantages. Compare *Brophy* v. *Cities Service Co.*, 31 Del. Ch. 241, 70 A.2d 5 (1949); *Ohio Oil Co.* v. *Sharp*, 135 F.2d 303 (10 Cir. 1943).

[7] This principle has been applied in analogous cases involving violations of the federal securities laws. In more than one instance, the corporation whose stock has been illegally traded has been permitted to recover conditionally in a Rule 10b-5 action because it is more equitable for it to recoup the rewards of the fraud than for the insider who profits by misusing corporate information to keep them. See *Securities and Exchange Commission* v. *Texas Gulf Sulphur*, 446 F.2d at 1308; *S.E.C.* v. *Golconda Mining Company*, 327 F.Supp. 257 (SDNY 1971).

This is firmly grounded in law and the rule is set forth in the American Law Institute's Restatement of Agency 2d § 312 (1958): "A person who, without being privileged to do so, intentionally causes or assists an agent to violate a duty to his principal is subject to liability to the principal." And see Comment c to § 312:

> A person who, with notice that an agent is thereby violating his duty to his principal, receives confidential information from the agent, may be enjoined from disclosing it and required to hold profits received by its use as a constructive trustee. * * * *

Therefore, if plaintiffs can prove their allegations, it would seem that liability of the Mutual Funds to Lum's must necessarily follow. Be that as it may be, however, the defendants Lehman Brothers and Simon contend that it would be inequitable to apply the rule to them because they did not personally profit by trading in Lum's stock and they hold no profits as constructive trustees of that corporation. Nevertheless, Lehman Brothers and Simon obviously misused inside information as much as Diversified and Investors misused it, and therefore we fail to see how equity would be furthered by imposing liability only on the Funds and not on the other participants who supplied the Funds with the inside information. It is well established that the liabilities of persons engaged in a joint enterprise to commit a wrong are both joint and several liabilities and each participant is liable to account for the profits of the other participants. *Marcus* v. *Otis*, 168 F.2d 649 (2 Cir. 1948), *modified*, 169 F.2d 148 (2 Cir. 1948); *Solomon* v. *United States*, 276 F.2d 669 (6 Cir. 1960), *cert. denied*, 364 U.S. 890 (1960), *reh. denied*, 364 U.S. 939 (1961). Accordingly, we hold that it would be proper to hold Lehman Brothers and Simon just as accountable for

the profits made by their tippees Diversified and Investors as the tippees themselves.[8]

Defendants also contend that the complaints are presently insufficient because they fail to allege with sufficient particularity the damages Lum's is claimed to have suffered. This contention is without merit. Although the Gregorio complaint fails to allege any damages to Lum's, the Schein complaint contains a general allegation of damages, and we find nothing in Florida law to require anything more than a general ad damnum allegation.[9]

Defendants also urge that inasmuch as there are private Rule 10b-5 class actions for damages, *e.g.*, *Sanders* v. *Lum's, Inc., et al.*, 70 Civ. 5331 (SDNY) and an administrative suit brought by the Securities and Exchange Commission, *SEC* v. *Lum's, et al.*, 70 Civ. 5280 (SDNY), pending in federal district court, defendants might be subjected to multiple liability if they are forced to remit to Lum's the profits the Mutual Funds made on their January 9 sales. Since appel-

[8] In passing we note decisions dealing with violations of the federal securities laws which involve the imposition of liability on defendants who have occupied statuses similar to the statuses occupied by defendants in this case. Thus, in *Securities and Exchange Commission* v. *Texas Gulf Sulphur*, 446 F.2d at 1308, the same argument raised by Simon and by Lehman Brothers was raised by defendant Darke. This court held that Darke was liable as a tippor for the profits realized by his tippees. Furthermore, "tippee liability," which is analogous to the liability being imposed upon Diversified and Investors, has been established in federal cases involving violations of the securities laws. See *Ross* v. *Licht*, 263 F.Supp. 395 (SDNY 1967); *In the Matter of Cady, Roberts & Co.*, 40 S.E.C. 907 (1961).

[9] We find it unnecessary to decide whether the defendants could prevail if *neither* complaint alleged damages to Lum's. We point out, however, that Florida law is not clear on the question and *Diamond* holds specifically that an allegation of damages is not a prerequisite to a recovery. *Diamond* v. *Oreamuno, supra* at 499. The case cited by defendants for the proposition that damages must be alleged (*Palma* v. *Zerbey*, 189 So.2d 510 (Fla.App. 1966), cert. denied, 200 So.2d 814 (Fla. 1967)) is a one paragraph per curiam opinion of a lower Florida court, the Florida District Court of Appeals which, inasmuch as it fails to provide a discussion of the issues, we find to be totally unpersuasive.

lees are fully aware of these federal court actions they are well able to protect themselves from multiple liability.[10]

Preventing those who are privy to confidential inside information from using it to their own advantage has found expression in numerous cases in the federal courts dealing with violations of the federal securities laws. See *Securities and Exchange Commission* v. *Texas Gulf Sulphur*, 401 F.2d 833 (2 Cir. 1968), *cert. denied sub nom. Coates* v. *SEC*, 394 U.S. 976 (1969); *List* v. *Fashion Park, Inc.*, 340 F.2d 457 (2 Cir. 1965), *cert. denied*, 382 U.S. 811 (1965); *Wohl* v. *Blair & Co.*, 50 F.R.D. 89 (SDNY 1970); *Ross* v. *Licht*, 263 F.Supp. 395 (SDNY 1967); *Speed* v. *Transamerica Corp.*, 99 F.Supp. 808, 828-829 (D.Del. 1951), *aff'd* 235 F.2d 369 (3 Cir. 1956).

Accordingly, as to those persons found to be within the jurisdiction of the court, we reverse the order appealed from and remand the case for such further proceedings below as may be consistent with the contents of this opinion.

KAUFMAN, *Circuit Judge* (dissenting):

In my view, it is no longer debatable that trading on inside information merits universal condemnation.[1] The undesirable nature of "insider trading" is reflected in the prophylactic provisions of Section 16(b) of the Securities Exchange Act of 1934 and the more general antifraud principles of Section 10b of that Act. I fully agree with Judges Waterman and Smith that one with access to material inside information concerning a corporation's affairs who

[10] See, for example, the method employed in *Securities and Exchange Commission* v. *Texas Gulf Sulphur Co.*, 312 F.Supp. 77, 93 (SDNY 1970), *aff'd in part, rev'd in part*, 446 F.2d 1301 (2 Cir. 1971), cert. denied, 404 U.S. 1005 (1971), reh. denied, 404 U.S. 1064 (1971).

[1] But for a contrary view, *see* H. Manne, Insider Trading and the Stock Market (1966).

knowingly purchases or sells that corporation's shares before this information has become publicly available takes unfair advantage of unknowledgeable parties to the transaction. Indeed, the factual claims contained in the complaints before us have led to two federal actions—an SEC injunctive action and a private class action under rule 10b-5—now pending in the District Court for the Southern District of New York. But the adage that hard facts make bad law is about to come true here, despite Judge, later Justice, Cardozo's warning that judges are not free agents roaming at will to create law to fit the facts. *See* The Nature of the Judicial Process 141 (1921). In the absence of any viable precedent upon which to base the totally new concept of law espoused by my brothers, it is clear that they announce an extraordinary, expansive, and incorrect reading of New York law solely because of their urge to "provid[e] a disincentive to insider trading." I agree with their objective but I question the means employed.

The court holds today that a person with no relationship whatsoever—fiduciary or otherwise—to a corporation, who trades its shares on the basis of material inside information becomes, *ipso facto,* a fiduciary of the corporation whose shares he traded and, accordingly, may be required in a *shareholders' derivative action*—not a Section 10(b) or 16(b) action—to pay his profits to the corporation. With all due respect to my brothers, the tortured reasoning to which they are compelled to resort in reaching this conclusion represents a distortion of the law of agency and the law of fiduciary responsibility in which I am unable to join. Accordingly, I dissent.

Stripped of excess verbiage, the complaints in the two consolidated stockholders' derivative actions before us make the following allegations. In January, 1970, Melvin Chasen, president of Lum's, learned that an earnings estimate of between $1.00 and $1.10 per share previously released to the

financial community was grossly inaccurate. A more realistic figure was $.76 per share. Chasen revealed this information on January 8, during a telephone conversation, to Benjamin Simon, an employee in Lehman Brothers Chicago office. Simon, in turn, disclosed the adverse news to Eugene Sit, portfolio manager of Investors Variable Payment Fund, Inc., who himself conveyed the information to James Jundt, portfolio manager of IDS New Dimensions Fund, Inc. Both Sit and Jundt are employees of Investors Diversified Services, Inc. (IDS), investment adviser to the two mutual funds. During the morning of Friday, January 9, prior to any public disclosure of the reduced earnings figure, the two mutual funds sold a total of 83,000 shares of Lum's stock on the New York Stock Exchange at a price of approximately $17.50 per share. Later that day, after the Exchange halted trading in Lum's shares, Lum's publicly announced the reduced earnings forecast. Trading did not resume until the following Monday, when the closing price fell to $14.00 per share.

It is important to note at the outset that the plaintiffs in these actions, shareholders of Lum's, do not claim to have suffered any damages themselves. Rather, these derivative suits are brought "on behalf of and for the benefit of Lum's." They seek to recover for Lum's treasury the windfall profit garnered by the IDS mutual funds, and assert that all defendants are jointly and severally liable for this amount. Thus, the proper method of analysis is not to focus on the unfairness of the mutual funds' profit at the expense of their purchasers—who have their own recourse for any wrongdoing—but on the strands of duty running to the corporation from the various individuals involved. The crux of the majority's holding is that the institutional defendants—Lehman Brothers, IDS, and the two mutual funds—and their employees—Simon, Sit, and

Jundt—are within the sweep of fiduciary principles announced in *Diamond* v. *Oreamuno*, 24 N.Y.2d 494, 301 N.Y.S.2d 78 (1969). But a careful examination of that case and the principles underlying it demonstrate that *Diamond* is wholly inapposite to this case.

In *Diamond*, the New York Court of Appeals dealt with a derivative action brought by a shareholder of Management Assistance, Inc. (MAI) against Oreamuno, chairman of the board of directors of the corporation, and Gonzalez, its president. The complaint charged that by virtue of their corporate positions, these officers knew that a supplier's price increase had caused MAI's earnings to decrease by more than 75% during a one month period. According to the allegations, the two officers sold over 50,000 MAI shares at a price of $28 per share prior to public disclosure of the adverse earnings figures, after which the price per share plummeted to $11. In reviewing the Appellate Division's refusal to order dismissal of the complaint against Oreamuno and Gonzalez, Chief Judge Fuld stated at the outset that "the question presented—one of first impression in this court—is whether *officers and directors* may be held accountable to their corporation for gains realized by them from transactions in the company's stock as a result of their use of material inside information," 24 N.Y.2d at 496, 301 N.Y.S.2d at 79 (emphasis added). A careful reading of the *Diamond* opinion reveals that Oreamuno's and Gonzalez's liability in a stockholders' derivative action was grounded solely in their having breached a fiduciary duty owed by them to MAI as corporate officials.

The inapplicability of these principles to any of the appellees[2] is readily apparent. The complaints here are

[2] As noted in the majority opinion, the only defendants remaining on appeal are Lehman Brothers, IDS, the two mutual funds, and Simon. The district court dismissed the actions against Chasen for lack of personal jurisdiction, a holding not challenged on appeal. Accordingly, this court need not comment on the nature and extent of Chasen's liability to Lum's because of his conduct.

barren of any allegation that the appellees—or Sit or Jundt —occupied any position, such as officer, director, employee, or agent, which would create fiduciary obligations to Lum's. *Compare Brophy* v. *Cities Service Co.*, 31 Del. Ch. 241, 70 A.2d 5 (1949); *Quinn* v. *Phipps*, 93 Fla. 805, 113 So. 419 (1927). Liability in *Diamond* was predicated entirely on such a relationship, and in its absence, the *Diamond* rationale for liability ceases to exist.

In an effort to bridge this fatal gap, the majority, without any basis in law or fact, reasons that the appellees were involved in a "joint" or "common enterprise" with Chasen, president of Lum's, "to misuse confidential corporate information for their own enrichment." By use of this interesting, but nevertheless fictional, theory, they seek to foist upon the appellees liability to Lum's for Chasen's improper behavior. But the facts alleged in the complaints are a far cry from the "conscious parallelism" cases, drawn from the antitrust field, cited as authority in the majority opinion; the facts simply do not comport with the concept of a joint enterprise, a term which implies the existence of a prior plan to carry out a mutually beneficial project. The complaints, read in the most favorable light to the plaintiffs, disclose nothing more than a seemingly unsolicited and haphazard revelation of certain information which was useful in making investment decisions. There are ample remedies under the federal securities laws to punish this conduct. But, I am unable to understand on what basis the majority transforms the appellees' spontaneous conduct into a nefarious, prearranged, and ongoing scheme so that "joint" or "common enterprise" principles can make them liable as fiduciaries of a corporation with which they have no relationship.

A primary authority upon which the majority relies, § 312 of the American Law Institute's Restatement of

Agency 2d, exposes the inappropriateness of holding the appellees liable to Lum's for their conduct. Section 312 provides that "A person who, without being privileged to do so, intentionally causes or assists an agent to violate a duty to his principal is subject to liability to the principal." Although Comment *c* to this section speaks generally of receipt of confidential information by a third person from a principal's agent, the central element of liability is the third party's active and intentional aiding in the agent's violation of a duty owed to his principal. In this case, Chasen's duty to Lum's was to not disclose confidential corporate information. Yet there is not a word in the complaint charging that the appellees actively solicited the disclosure or that they had concocted a prearranged scheme with Chasen.[3] We are dealing here with an isolated transaction.

In the absence of any coherent legal theory, I cannot join my brothers in approving the use of the shareholders' derivative action device merely because, as my brothers candidly admit, to do so possibly may have a deterrent effect on "insider trading." Although developments in federal securities law indicate an expanding scope of liability for tippee traders, *see In re* Investors Management Co., Securities and Exchange Commission Release No. 34-9267 (Jul. 29, 1971) (SEC sanctioning of institutional investors

3. It is of no small significance that in the *Diamond* litigation, the Appellate Division affirmed dismissal of the complaint against other MAI directors—fiduciaries to the corporation—who allegedly "approved, acquiesced in or ratified" Oreamuno's and Gonzalez's transactions. 29 A.D.2d 285, 287 N.Y.S.2d 300 (1968). Despite the majority's effort in a footnote to "distinguish" this disposition, I believe the Appellate Division's action is clearly dispositive of the point before us. If the New York courts would not impose liability upon a director—a fiduciary of the corporation—who took no affirmative steps to cause or assist in a breach of a fiduciary duty by the corporation's president, I fail to see by what logic it can be urged that New York courts would hold liable a non-fiduciary who did not cause or assist in the breach.

who sold a corporation's shares after the corporation's underwriter revealed adverse earnings results to them); *cf. SEC* v. *Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1308 (2d Cir. 1971), *cert. denied*, 404 U.S. 1005 (1972) (affirming district court order in SEC injunctive suit, requiring a "tippor" to divest an amount equal to his tippees' profits), the impetus for developing this expanded federal law liability—whose exact nature and scope remain in a formative stage— is the need to maintain free and honest securities markets. This need appropriately is given great weight when we consider claims under the federal securities law. But it is inapposite in determining whether, *under state common law,* tippee trading is a breach of a fiduciary duty owed to the corporation whose shares are traded, and if so, whether such a breach is remediable through use of a shareholders' derivative action.

In these actions, where jurisdiction is grounded solely in diversity of citizenship, the parties and the majority agree that our duty is to apply the law of Florida. Yet because there are no pertinent Florida decisions, the majority focuses on a New York decision, *Diamond* v. *Oreamuno, supra.* Thus, liability is founded on the conclusion of two federal judges that the Florida Supreme Court, if the instant case was before it, would look to a New York decision and, in addition, would give an unprecedented expansive reading to that case.

Despite the manner in which the majority opinion convolutes the law and the facts in this case, a view that a tippee is cloaked with state law fiduciary obligations to the corporation whose shares he trades is an unknown and untenable legal concept. Neither *Diamond*—itself a significant alteration of the common law principles applicable to

an officer's or director's trading in his corporation's shares[4] —nor the law of agency support such a holding. Nothing in the majority opinion tells us why or on what grounds a New York court would hold a tippee trader liable to the corporation for his profits under common law fiduciary principles, and the court exceeds its authority by substituting its own view of what state law ought to be, for what the state law actually is.

Moreover, since the outcome of this case turns, ultimately, upon Florida law, I fail to comprehend why my brothers refuse to utilize Florida's certified question statute, Fla. Stat. Ann. §25.031.[5] This enlightened law provides for certification to the Florida Supreme Court by a federal appellate court of an unresolved question of Florida law which is determinative of a case before it and on which there are no clear, controlling Florida Supreme Court precedents. The statute states that the court, by

4. *See* Note, 1970 Wis. L. Rev. 576, 577. Although not dispositive, this fact augurs against assuming the state courts could make the broad holding so readily attributed to them by the majority.

5. The supreme court of this state may, by rule of court provide that, when it shall appear to the supreme court of the United States, to any circuit court of appeals of the United States, or to the court of appeals of the District of Columbia, that there are involved in any proceeding before it questions or propositions of the laws of this state, which are determinative of the said cause, and there are no clear controlling precedents in the decisions of the supreme court of this state, such federal appellate court may certify such questions or propositions of the laws of this state to the supreme court of this state for instructions concerning such questions or propositions of state law, which certificate the supreme court of this state, by written opinion, may answer.

This statutory authority has been implemented by Appellate Rule 4.61.

written opinion, then may answer the certified question. *See Aldrich* v. *Aldrich*, 375 U.S. 249 (1963); *Green* v. *American Tobacco Co.*, 304 F. 2d 170 (5th Cir. 1962). The uncertainty inherent in the majority's speculation over what the Florida courts would decide if faced with this novel question of tippee liability under state common law fiduciary principles in a stockholders' derivative action would be dispelled authoritatively and finally.

Accordingly, I respectfully dissent.

Judgment of the Court of Appeals
Dated May 10, 1973

UNITED STATES COURT OF APPEALS
FOR THE
SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the tenth day of May, one thousand nine hundred and seventy-three.

Present—Hon. STERRY R. WATERMAN
Hon. J. JOSEPH SMITH
Hon. IRVING R. KAUFMAN, Circuit Judges.

72-1373—72-1375

JACOB SCHEIN and MARVIN H. SCHEIN,
Plaintiffs-Appellants,

v.

MELVIN CHASEN; INVESTORS DIVERSIFIED SERVICES, INC.; LEHMAN BROTHERS; INVESTORS VARIABLE PAYMENT FUND, INC.; BENJAMIN SIMON; IDS; NEW DIMENSIONS FUND, INC.; EUGENE C. SIT; JAMES R. JUNDT and LUM'S, INC.,
Defendants-Appellees.

ANTONE F. GREGORIO, individually and as representative of all persons similarly situated as a class under Rule 23 FRCP,
Plaintiff-Appellant,

v.

LUM'S INC., MELVIN CHASEN, LEHMAN BROTHERS, BENJAMIN SIMON, INVESTORS DIVERSIFIED SERVICES, INC., EUGENE C. SIT and JAMES R. JUNDT,
Defendants-Appellees.

Appeal from the United States District Court for the Southern district of New York.

Judgment of the Court of Appeals
Dated May 10, 1973

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is reversed and that the action be and it hereby is remanded to said District Court for further precedings consistent with the opinion of this court with costs to be taxed against the appellees.

A. Daniel Fusaro
Clerk

Order of the Court of Appeals
Dated June 8, 1973
Denying Petition of Benjamin Simon for Rehearing in Banc

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House in the City of New York, on the eighth day of June, one thousand nine hundred and seventy-three

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JACOB SCHEIN and MARVIN H. SCHEIN,
Plaintiffs-Appellants,

v.

MELVIN CHASEN; INVESTORS DIVERSIFIED SERVICES, INC.; LEHMAN BROTHERS; INVESTORS VARIABLE PAYMENT FUND, INC.; BENJAMIN SIMON; IDS; NEW DIMENSIONS FUND, INC.; EUGENE S. SIT; JAMES R. JUNDT and LUM'S, INC.,
Defendants-Appellees.

ANTONE F. GREGORIO, individually and as representative of all persons similarly situated as a class under Rule 23 FRCP,
Plaintiff-Appellant,

v.

LUM'S INC., MELVIN CHASEN; LEHMAN BROTHERS; BENJAMIN SIMON; INVESTORS DIVERSIFIED SERVICES, INC.; EUGENE S. SIT and JAMES R. JUNDT,
Defendants-Appellees.

A petition for rehearing in banc having been filed herein by counsel for the Defendant-Appellee Benjamin Simon and no active circuit judge having requested that a vote be taken on said suggestion

Upon consideration thereof, it is

Ordered that said petition be and it hereby is denied.

A. DANIEL FUSARO
Clerk

Order of the Court of Appeals
Dated June 8, 1973
Denying Petition of Lehman Brothers for Rehearing in Banc

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the eighth day of June, one thousand nine hundred and seventy-three

---

JACOB SCHEIN and MARVIN H. SCHEIN,
Plaintiffs-Appellants,

v.

MELVIN CHASEN; INVESTORS DIVERSIFIED SERVICES, INC.; LEHMAN BROTHERS; INVESTORS VARIABLE PAYMENT FUND, INC.; BENJAMIN SIMON; IDS; NEW DIMENSIONS FUND, INC.; EUGENE S. SIT; JAMES R. JUNDT and LUM'S, INC.,
Defendants-Appellees.

ANTONE F. GREGORIO, individually and as representative of all persons similarly situated as a class under Rule 23 FRCP,
Plaintiff-Appellant,

v.

LUM'S INC., MELVIN CHASEN, LEHMAN BROTHERS, BENJAMIN SIMON, INVESTORS DIVERSIFIED SERVICES, INC., EUGENE S. SIT and JAMES R. JUNDT,
Defendants-Appellees,

A petition for rehearing in banc having been filed herein by counsel for the appellee Lehman Brothers and no active circuit judge having requested that a vote be taken on said suggestion

Upon consideration thereof, it is

Ordered that said petition be and it hereby is denied.

A. DANIEL FUSARO
Clerk

Order of the Court of Appeals
Dated June 18, 1973

Denying Petition of IDS Defendants for Rehearing

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

Docket Nos. 72-1373, 72-1375

At a stated term of the United States Court of Appeals in and for the Second Circuit held at the United States Court House, in the City of New York on the eighteenth day of June, one thousand nine hundred and seventy-three.

Present: Hon. IRVING R. KAUFMAN
Hon. S. R. WATERMAN
Hon. J. JOSEPH SMITH, Circuit Judges.

JACOB SCHEIN and MARVIN H. SCHEIN,
Plaintiffs-Appellants,

v.

MELVIN CHASEN; INVESTORS DIVERSIFIED SERVICES, INC.; LEHMAN BROTHERS; INVESTORS VARIABLE PAYMENT FUND, INC.; BENJAMIN SIMON; IDS; NEW DIMENSIONS FUND, INC.; EUGENE S. SIT; JAMES R. JUNDT and LUM'S, INC.,
Defendants-Appellees.

ANTONE F. GREGORIO, individually and as representative of all persons similarly situated as a class under Rule 23 FRCP,

Plaintiff-Appellant,

v.

LUM'S, INC.; MELVIN CHASEN, LEHMAN BROTHERS; BENJAMIN SIMON; INVESTORS DIVERSIFIED SERVICES, INC.; EUGENE S. SIT; and JAMES R. JUNDT,

Defendants-Appellees.

A petition for a rehearing having been filed herein for counsel for the appellees Investors Diversified Services, Inc., Investors Variable Payment Fund, Inc., and IDS New Dimensions Fund, Inc.,

Upon consideration thereof, it is

Ordered that said petition be and it hereby is denied.

A. DANIEL FUSARO
Clerk

Order of the Court of Appeals
Dated June 18, 1973
Denying Petition of IDS Defendants for Rehearing in Banc

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

Docket Nos. 72-1373, 72-1375

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the eigthteenth day of June, one thousand nine hundred and seventy-three,

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JACOB SCHEIN and MARVIN H. SCHEIN,
Plaintiffs-Appellants,

v.

MELVIN CHASEN; INVESTORS DIVERSIFIED SERVICES, INC.; LEHMAN BROTHERS; INVESTORS VARIABLE PAYMENT FUND, INC.; BENJAMIN SIMON; IDS; NEW DIMENSIONS FUND, INC.; EUGENE S. SIT; JAMES R. JUNDT and LUM'S, INC.;
Defendants-Appellees.

ANTONE F. GREGORIO, individually and as representative of all persons similarly situated as a class under Rule 23 FRCP,
Plaintiff-Appellant,

v.

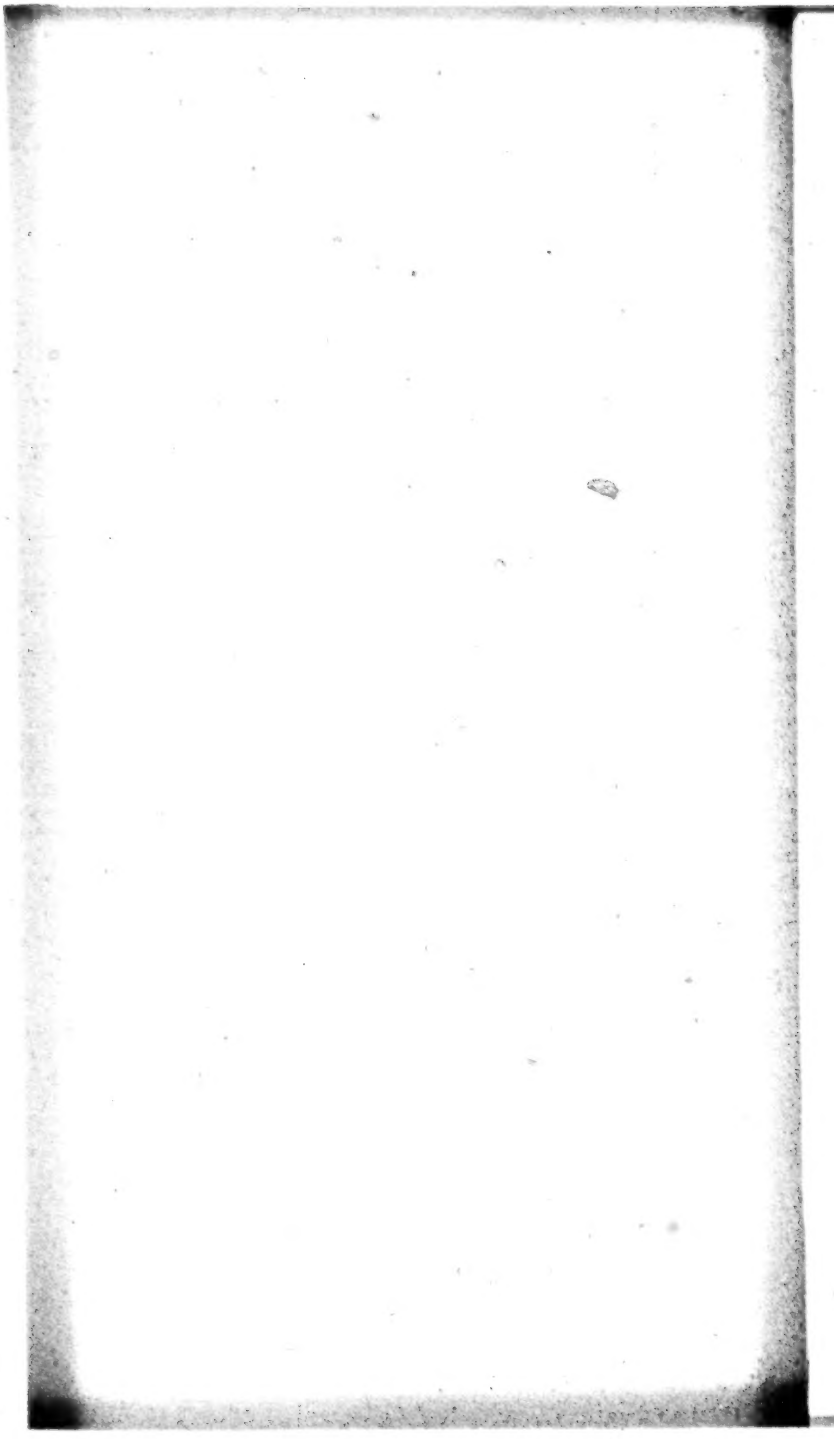
LUM'S, INC.; MELVIN CHASEN, LEHMAN BROTHERS; BENJAMIN SIMON; INVESTORS DIVERSIFIED SERVICES, INC.; EUGENE S. SIT and JAMES R. JUNDT,
Defendants-Appellees.

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for the appellees Investors Diversified Services, Inc., Investors Variable Payment Fund, Inc., and IDS New Dimensions Fund, Inc., and no active circuit judge having requested that a vote be taken on said suggestion.

Upon consideration thereof, it is

Ordered that said petition be and it hereby is denied.

A. DANIEL FUSARO
Clerk



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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-439

LEHMAN BROTHERS,

Petitioner,

v.

JACOB SCHEIN; MARVIN H. SCHEIN; ANTONE F. GREGORIO; LUM'S INC.; MELVIN CHASEN; BENJAMIN SIMON; INVESTORS DIVERSIFIED SERVICES, INC.; INVESTORS VARIABLE PAYMENT FUND, INC.; IDS NEW DIMENSIONS FUND, INC.; EUGENE S. SIT; and JAMES R. JUNDT,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

JAMES J. HAGAN
One Battery Park Plaza
New York, New York 10004
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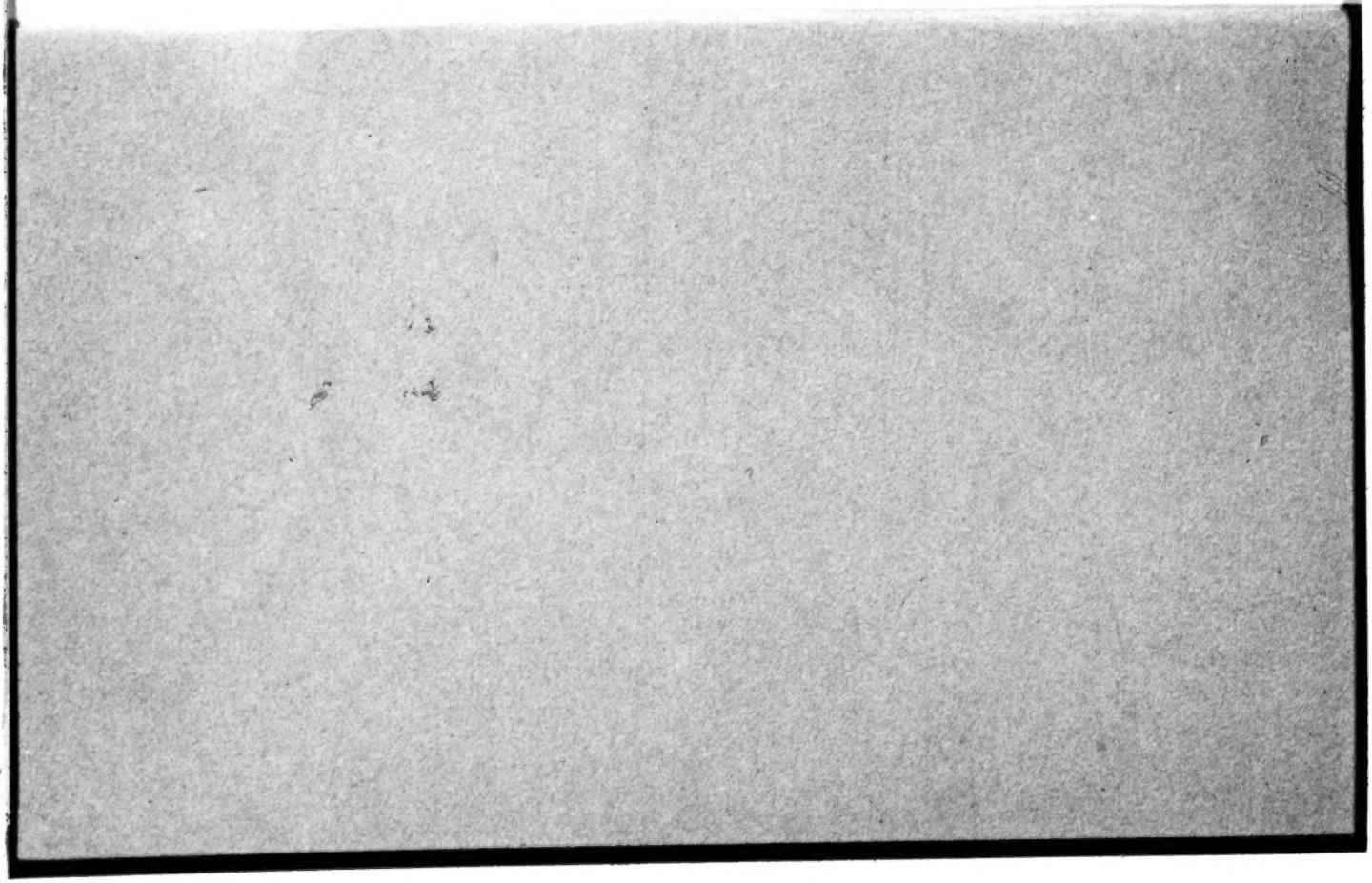
Of Counsel:
LINDSAY A. LOVEJOY, JR.
SIMPSON THACHER & BARTLETT

September 6, 1973



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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No.

LEHMAN BROTHERS,

Petitioner,

v.

JACOB SCHEIN, *et al.*,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Lehman Brothers ("Lehman") petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit entered on May 10, 1973 and the order of that court entered on June 8, 1973 denying Lehman's petition for rehearing in banc. The court below reversed the order of the United States District Court for the Southern District of New York, which had dismissed the complaints against Lehman and the other defendants.

Opinions Below

The majority and dissenting opinions of the Court of Appeals, rendered May 10, 1973, are reported at 478 F.2d 817 (12A[1]); the opinion of the District Court, which was

1. Citations with the suffix "A" are to the Appendix hereto.

reversed by the Court of Appeals, is reported at 335 F. Supp. 329 (1A).

Jurisdiction

The judgment of the Court of Appeals was entered on May 10, 1973 (33A), and a timely petition for rehearing filed by the petitioner herein was denied by the Court of Appeals on June 8, 1973 (36A). This petition was filed within 90 days of that date. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

Questions Presented

1. In this diversity action brought in the Southern District of New York, but governed by Florida law, should the Court of Appeals have certified the decisive issue of law to the Supreme Court of Florida, in accordance with established practice in other circuits, to permit the State Court to decide whether a novel rule of public policy would be adopted as the law of Florida, in a situation where Florida's interests are vital and paramount?

2. Has the Court of Appeals properly performed its duty under *Erie R. R.* v. *Tompkins,* 304 U.S. 64 (1938), in holding that Florida law gives a Florida corporation an equitable right to recover from a stockbroker profits allegedly made by a third party mutual fund on the ground that such mutual fund sold stock in the corporation on the basis of inside information received from a company officer through the stockbroker, where the stockbroker performed no transactions and made no profits?

Statutes Involved

Florida law, FLA. STAT. ANN. §25.031 (1961), provides that

> "The supreme court of this state may, by rule of court, provide that, when it shall appear to the supreme court of the United States, to any circuit court of appeals of the United States, or to the court of appeals of the District of Columbia, that there are involved in any proceeding before it questions or propositions of the laws of this state, which are determinative of the said cause, and there are no clear controlling precedents in the decisions of the supreme court of this state, such federal appellate court may certify such questions or propositions of the laws of this state to the supreme court of this state for instructions concerning such questions or propositions of state law, which certificate the supreme court of this state, by written opinion, may answer."

In addition the Supreme Court of Florida is enabled by statute to effectuate §25.031 by rulemaking, FLA. STAT. ANN. §25.032 (1961):

> "The supreme court of this state is hereby authorized and empowered to collaborate with any and all other courts of last resort, of other states and of the United States, in the preparation and approval of uniform rules of court to make effective this and similar laws."

Pursuant to §25.032, the Supreme Court of Florida promulgated FLA. APP. RULES, R. 4.61 (1967):

> RULE 4.61. Certified Questions from Federal Courts
>
> a. When Certified. When it shall appear to the Supreme Court of the United States, or to any of the Courts of Appeal of the United States that there are involved in any proceeding before it questions or propositions of law of this state which are determinative of said cause and that there are no clear controlling precedents in the decisions of the

Supreme Court of this state, such federal appellate court may certify such questions or propositions of law of this state to the Supreme Court of Florida for instructions concerning such questions or propositions of state law.

b. Jurisdiction. Questions or propositions of law referred to in sub-paragraph a hereof shall be certified for answer to the Supreme Court of this state.

c. Method of Invoking Rule. The provisions of this rule may be invoked by any of the federal courts referred to in sub-paragraph a hereof upon its own motion or upon the suggestion or motion of any interested party when approved by such federal court.

d. Contents of Certificate. The certificate provided for herein shall contain the style of the case, a statement of facts showing the nature of the cause and the circumstances out of which the questions or propositions of law arise and the question of law to be answered.

e. Preparation of Certificate. The certificate may be prepared by stipulation or as directed by such federal court. When prepared and signed by the presiding judge of said federal court, it shall be certified to the Supreme Court by the Clerk of the federal court and under its official seal. The Supreme Court may, in its discretion, require the original or copies of all or any portion of the record before the federal court to be filed with said certificate where, in its opinion, such record may be necessary in the determination of said cause.

f. Costs of Certificate. The costs of the certificate and filing fee shall be equally divided between the parties unless otherwise ordered by this Court.

g. Briefs and Argument. The appellant or moving party in the federal court shall file and serve

upon its adversary its brief on the question certified within 30 days after the filing of said certificate in the appellate court of this state having jurisdiction. The appellee or responding party in the federal court shall file and serve upon its adversary its brief within 20 days after the receipt of appellant's or moving party's brief and a reply brief shall be filed within 10 days thereafter.

h. Oral Argument. Oral argument may be granted upon application and, unless for good cause shown the time be enlarged by special order of the Court prior to the hearing thereon, the parties shall be allowed the same time as in other causes on the merits.

Statement of the Case

Lehman was named as a defendant in three shareholder's derivative suits brought in the Southern District of New York on the basis of diversity of citizenship, 28 U.S.C. § 1332(a)(1).[2] The complaints are similar; the actions have been dealt with on a consolidated basis below, and they are so treated here.[3] Plaintiffs are shareholders of the nominal defendant Lum's, Inc. ("Lum's"), a Florida corporation with its principal place of business in Miami. They allege

2. *Gildenhorn* v. *Lum's, Inc.*, No. 70 Civ. 5733 (filed Dec. 29, 1970); *Gregorio* v. *Lum's, Inc.*, No. 71 Civ. 1925 (filed Jan. 12, 1971); and *Schein* v. *Chasen*, No. 71 Civ. 4218 (filed Sept. 24, 1971).

3. Only the *Schein* and *Gregorio* cases are involved here, since an appeal in *Gildenhorn* was not pursued. The full captions of the actions, indicating the alignment of the parties, are as follows:

Jacob Schein and Marvin H. Schein, Plaintiffs, v. Melvin Chasen; Investors Diversified Services, Inc.; Lehman Brothers; Investors Variable Payment Fund, Inc.; Benjamin Simon; IDS New Dimensions Fund, Inc.; Eugene S. Sit; James R. Jundt; and Lum's Inc., Defendants.

Antone F. Gregorio, Plaintiff, v. Lum's, Inc.; Melvin Chasen; Lehman Brothers; Investors Diversified Services, Inc.; Eugene C. Sit; and James R. Jundt, Defendants.

that on January 8, 1970 the defendant Melvin Chasen, president of Lum's, with his office in Miami, telephoned the defendant Benjamin Simon, a registered representative in the Chicago office of Lehman, and disclosed certain unfavorable projections of Lum's earnings. Such information was not then public.

Allegedly Simon then gave this information to the IDS defendants[4] in Minneapolis. On the next day the IDS defendants allegedly sold 83,000 shares of Lum's common stock on the New York Stock Exchange at about $17.50 per share. Later that day the Exhange halted trading in Lum's stock, whereupon the company publicly stated that projected second-quarter earnings would be "substantially lower" than anticipated and that first-half earnings would be about 20% below the previous year's level (*Gregorio* complaint ¶ 20; *Schein* complaint ¶ 23). On the next trading day Lum's stock opened at $14.00 per share (*Schein* complaint ¶ 24).

The *Schein* complaint alleges that Chasen received the information in a fiduciary capacity and disclosed it in violation of that duty. (*Schein* complaint ¶¶ 16, 18, 25). It alleges that the other defendants aided and abetted such violation, used such information "for their own personal profit", and are liable to Lum's for such "unlawful profits (including commissions)" and for "the damages it sustained thereby" (*Id.*, ¶ 25), and it demands an "accounting" (*Id.*, ¶ 26). The *Gregorio* complaint alleges that the information was "an asset" of Lum's (*Gregorio* complaint ¶ 22)

4. The defendants Investors Diversified Services, Inc.; Investors Variable Payment Fund, Inc.; and IDS New Dimensions Fund, Inc. are collectively referred to as "the IDS defendants." The defendants Eugene S. Sit and James R. Jundt are alleged to be employees of Investors Diversified Services, Inc. Allegedly Sit received the information from Simon and gave it to Jundt. Both Sit and Jundt were dismissed from the cases by the District Court for lack of personal jurisdiction (2A n.1).

and that defendants "must account to Lum's, Inc. for the profits realized by them" (*Id.*).

Lehman, Simon, Chasen, and the IDS defendants moved to dismiss the complaints for failure to state a claim on which relief can be granted, FRCP 12(b)(6); Simon and Chasen also asserted a lack of personal jurisdiction, FRCP 12(b)(2). Affidavits of Simon and of Mr. Herbert Lisle, a Lehman partner, were presented on the motions and not excluded, FRCP 12(b). These established that the IDS defendants' sales were not executed by Lehman and that neither Lehman nor Simon received any benefit from the sales. The District Court's finding that the "broker-dealer defendants . . . did not profit by virtue of the sales" (6A) states the undisputed facts.[5]

The District Court, Hon. Harold R. Tyler, Jr., J., rejected the plaintiffs' arguments that New York substantive law applied; following New York choice of law principles, see *Klaxon Co.* v. *Stentor Electric Manufacturing Co.*, 313 U.S. 487 (1941), it held that the law of the state of incorporation, here Florida, governed the nature of fiduciary obligations to a corporation (3A-4A). It buttressed this conclusion with the "governmental interest" analysis applied by New York courts in resolving conflict of laws issues, finding Florida law controlling since

> "Florida has the paramount interest in defining and enforcing fiduciary obligations owing to corporations incorporated and doing business within its borders" (4A).

And it noted (*Id.*) that the New York Court of Appeals had expressly stated, as to fiduciary duties to corporations, that the

5. Plaintiffs had thirty days in which to file papers in opposition: they filed neither affidavits suggesting any factual issue, nor affidavits showing inability to present contrary evidence, FRCP 56(f). Thus there is no dispute that Lehman received no benefit in the transactions sued upon, FRCP 56(c).

> "primary source of law in this area ever remains that of the State which created the corporation." *Diamond* v. *Oreamuno*, 24 N.Y.2d 494, 503-04, 248 N.E.2d 910 (1969).

Examining Florida precedents, Judge Tyler noted that, although the Florida Supreme Court had not yet decided the issue, lower Florida courts had held that a shareholder's derivative complaint alleging breach of fiduciary duties was insufficient if it did not allege some form of damage to the corporation (5A).

Recognizing that the *Schein* complaint made at least a conclusory allegation of "damage" and also that out-of-state precedents might be argued to a Florida court, the court tested the allegations of the various complaints by the standards of a 1969 New York decision which the plaintiffs urged was dispositive, *Diamond* v. *Oreamuno, supra.*

In *Diamond,* the New York Court of Appeals held that directors of a corporation were liable to the corporation in a derivative action for profits they made by selling the company's stock based on inside information, the court reasoning that such information was an "asset" of the company which had been acquired by the directors as fiduciaries and misappropriated in violation of trust. Since under the usual rule a company can only recover from a fiduciary for loss of a lawful business opportunity, and since the company itself could not lawfully sell stock on inside information, the holding that the company has "a higher claim to the proceeds", *id.* 498, of wrongful market activity was a novel break from precedent (see Point III, *infra*).

The District Court, however, held that none of the defendants in these cases came within the *Diamond* rule. Chasen was a fiduciary, but he sold no stock and made no profits.[6]

6. The District Court was not required to determine whether Chasen came within an expanded view of *Diamond,* since he, the only fiduciary in the case, was dismissed as improperly served (7A).

The IDS defendants might have profited, but they were not fiduciaries. And Lehman and Simon were doubly excluded, since they were not fiduciaries, and they made no profits (6A). The court declined the plaintiffs' invitation to extend the rule of *Diamond* to hold liable corporate outsiders like IDS and Lehman, especially since such "outside individuals, corporations, or institutions" were already "subject to other private and governmental restraints on their behavior" (7A). Accordingly, the complaints were dismissed. Plaintiffs in the *Schein* and *Gregorio* cases appealed.[7]

The Court of Appeals, in an opinion by Judge Waterman (12A), held the complaints sufficient as to the IDS defendants, Simon, and Lehman.[8] Plaintiffs conceded on appeal, in a reversal of their position in the District Court, that Florida law controlled (14A n. 3), but the court found no pertinent Florida rulings (17A). In such case it felt free to turn to the "law of other jurisdictions and particularly that of New York where the resolution of the issues in the *Diamond* case . . . bears on the issues". (*Id.*) Having done so, the court said, its task was to "interpret *Diamond* as the Florida court would probably interpret it" (*Id.*). The only remaining question, it said, was "whether the *Diamond* holding should extend to reach third parties" who are "involved with directors in a common enterprise" (18A). Conceding that the complaints failed to allege any such common enterprise between the defendants and Chasen, the only fiduciary, the court said that a "common enterprise" might still be proved under the pleadings (*Id.*). And it held that nothing in *Diamond* excluded "co-venturers" from joint and several liability for a breach of fiduciary duty (19A).

7. An appeal in *Gildenhorn* v. *Lum's, Inc.*, No. 70 Civ. 5733, was noted but not pursued (14A n.2).

8. Dismissal of the defendant Chasen for lack of personsal jurisdiction was not challenged on appeal (27A n.2).

In so interpreting *Diamond,* the court stated that its purpose was to protect the interest of "the injured corporation" in its "prestige" and "good will" (20A). It also expressed fear that the "prophylactic effect" of *"Diamond,* the law of the jurisdiction in which the New York Stock Exchange is located", might be defeated if non-fiduciaries were "immunized" (*Id.*)[9].

The Court of Appeals held that Lehman and Simon might be liable to Lum's, even though they realized no profit from the IDS sales, under the "well established" principle that "persons engaged in a joint enterprise to commit a wrong" are liable "for the profits of other participants" (22A). The opinion closed with several citations to federal securities law decisions and the comment that:

> "Preventing those who are privy to confidential inside information from using it to their own advantage has found expression in numerous cases in the federal courts dealing with violations of the federal securities laws." (24A)

Judge Kaufman, in dissent (24A), agreed that those who profit by insider trading deserve "universal condemnation" (24A) but stressed that the majority had created a "totally new concept of law" (25A) that was wholly without precedent and amounted to

> "an extraordinary, expansive, and incorrect reading of *New York law*" (*Id.*) (emphasis supplied).

He pointed out that the foundation of the majority's theory, a fiduciary duty running to the corporation, was nonex-

9. In support of its ruling the court cited only one Florida case, *Quinn* v. *Phipps,* 93 Fla. 805, 113 So. 419 (1927), in which a real estate agent was held liable when, in conflict with his principal, he appropriated a business opportunity. The case does not concern and says nothing about the conduct of non-fiduciaries or the liability of persons who do not profit.

istent in the case of Lehman, Simon and the IDS defendants. The majority, he said, tried to "bridge this fatal gap" (28A) with the help of the "common enterprise" notion, which was not alleged in the complaints and seemed wholly "fictional" (*Id.*). Rather the complaints, generously read, disclosed "nothing more than a seemingly unsolicited and haphazard revelation of certain information" (*Id.*).

Judge Kaufman added that any loss to purchasers of stock from IDS could be fully remedied in private and government suits under federal law, which are now pending (25A). He stated that federal cases expanding the liability of "tippee" traders, relied on by the majority, appropriately gave great weight to the public interest in maintaining free and honest securities markets, but that such federal interests did not apply

> "in determining whether, *under state common law*, tippee trading is a breach of fiduciary duty owed to the corporation whose shares are traded, and if so, whether such a breach is remediable through use of a shareholders' derivative action" (30A) (italics original).

In closing, Judge Kaufman said he could not understand why the majority refused to use the "enlightened" (31A) Florida certification procedure to secure an authoritative ruling on a state-law point on which it was concededly without guidance:

> "The uncertainty inherent in the majority's speculation over what the Florida courts would decide if faced with this novel question of tippee liability under state common law fiduciary principles in a stockholders' derivative action would be dispelled authoritatively and finally" (32A).

Lehman made a timely motion for rehearing, in which it pointed out that *Diamond* v. *Oreamuno, supra,* constituted

an extreme minority position, if not a unique one, and that the majority had erred in assuming that Florida courts would both embrace and expand it. Lehman specifically requested that the question be referred to the Supreme Court of Florida for authoritative resolution pursuant to FLA. STAT. ANN. § 25.031 (Suggestion for Rehearing in banc by Appellee Lehman Brothers, at 9-10 (May 24, 1973)). The petition was denied (36A).[10]

Reasons for Granting the Writ

POINT I

In Refusing to Certify the Controlling Public Policy Issue to the Supreme Court of Florida, the Court of Appeals Departed from Prior Decisions of this Court.

The fundamental fact of this case is that Florida is the jurisdiction with the paramount interest in formulating the legal principle involved. The Court of Appeals recognized that there were no Florida decisions on point, but it refused, over dissent, to use the most certain way to determine Florida law, namely, by certification to the Supreme Court of Florida pursuant to a statutory procedure[11]. Instead, without statement of reasons, it imported the unique *Diamond* rule from New York and erroneously extended "the 'stretch' of *Diamond*" (19A) to penalize persons no state has ever held liable. Simply put, Lehman's position is this:

10. Motions for rehearing, including the suggestion that the case be heard in banc, were also made by Simon and the IDS defendants, and were likewise denied (35A, 37A, 38A).

11. FLA. STAT. ANN. §§ 25.031, 25.032 (1961); see "Statutes Involved", *supra*, pp. 2-3.

First, prior decisions of this Court required the Second Circuit to abstain from ruling and to permit Florida to decide this important issue of Florida law and public policy.

Second, since the Court of Appeals could have certified the question for a speedy and definitive ruling by the Supreme Court of Florida, its refusal to do so is doubly erroneous. It departs from the practice in other circuits and rejects a procedure this Court has used and encouraged other federal courts to use. The ruling below thus raises issues of recurrent importance to the fair and efficient administration of the federal courts.

A. The decisions of this Court required abstention.

It is commonplace that in specific circumstances where a lawsuit calls for decision of a difficult and unsettled question of state law, and an incorrect decision might cause unnecessary interference with state policies, a federal court will abstain from decision until the state court can rule authoritatively on the issue.

Thus abstention is proper if a constitutional question may be avoided:

> "The paradigm case for abstention arises when the challenged state statute is susceptible of 'a construction by the state courts that would avoid or modify the [federal] constitutional question. *Harrison* v. *NAACP*, 360 U.S. 167. Compare *Baggett* v. *Bullitt*, 377 U.S. 360,' *Zwickler* v. *Koota, supra*, at 249." *Lake Carriers' Association* v. *MacMullan*, 406 U.S. 498, 510-11 (1972).

Accord: *Askew* v. *Hargrave*, 401 U.S. 476 (1971); *Fornaris* v. *Ridge Tool Co.*, 400 U.S. 41 (1970); *Reetz* v. *Bozanich*, 397 U.S. 82 (1970); *Railroad Commission* v. *Pullman Co.*, 312 U.S. 496 (1941).

Avoidance of a constitutional issue is, however, only one of the concerns which compels abstention. In *Chicago* v. *Fieldcrest Dairies, Inc.*, 316 U.S. 168 (1942), the Court ordered abstention, declining to chance "needless friction with state policies" by a "tentative decision" on the effect of possibly conflicting state and city legislation on a private business, *id.*, 172, where the issues could be settled by "an authoritative and controlling determination by the state tribunals," *id.* The Court specifically noted that any constitutional issues did not seem substantial and that avoidance of such issues was only an additional ground for abstention, *id.*, 173.[12] In *Thompson* v. *Magnolia Petroleum Co.*, 309 U.S. 478 (1940), the Court ordered that the interpretation of certain documents, which granted interests in land to a bankrupt, be submitted to the courts of Illinois, lest the parties' rights be prejudiced because of "the accident of federal jurisdiction," *id.*, 484.

Thus several considerations traditionally call for abstention, such as avoiding interference with development of important state policies by aberrational federal decisions:

> "Reflected among the concerns which have traditionally counseled a federal court to stay its hand are the desirability of avoiding unseemly conflict between two sovereignties, the unnecessary impairment of state functions, and the premature determination of constitutional questions." *Martin* v. *Creasy*, 360 U.S. 219, 224 (1959).

In *Louisiana Power & Light Co.* v. *City of Thibodaux*, 360 U.S. 25 (1959), a diversity case turning on the interpretation of state eminent domain laws, the Court directed abstention pending a decision by the courts of Louisiana

12. See *Zwickler* v. *Koota*, 389 U.S. 241 (1967), where the Court again pointed out that circumstances other than the opportunity to avoid a constitutional question had arisen in diversity cases and had been determined to require abstention. *Id.*, 249 n.11.

on the legality of a condemnation. To do otherwise, the Court explained, would create the risk of unequal application of important state policy:

> "A Louisiana statute apparently seems to grant such a power. But that statute has never been interpreted, in respect to a situation like that before the judge, by the Louisiana courts and it would not be the first time that the authoritative tribunal has found in a statute less than meets the outsider's eye. Informed local courts may find meaning not discernible to the outsider. The consequence of allowing this to come to pass would be that this case would be the only case in which the Louisiana statute is construed as we would construe it, whereas the rights of all other litigants would be thereafter governed by a decision of the Supreme Court of Louisiana quite different from ours." *Id.*, 30.

Although the city pressed for a decision, the Court reinstated the District Court's stay rather than permit the case to be decided by "a forecast rather than a determination," *Id.*, 27, citing *Railroad Commission* v. *Pullman Co., supra,* 499. Mr. Justice Stewart's statement of the action approved in *Thibodaux,* that

> "In a conscientious effort to do justice the District Court deferred immediate adjudication of this controversy pending authoritative clarification of a controlling state statute of highly doubtful meaning." *Louisiana Power & Light Co.* v. *City of Thibodaux, supra,* 31 (concurring opinion),

makes plain that *Thibodaux* authorizes abstention in cases involving far less significant public policy choices than those that require it here.

And *Thibodaux* clearly requires abstention in cases like this one, where unsettled questions of state law and significant areas of state concern coincide:

> "[Q]uestions may be deserving of state determination because they deal with an area of law which is undergoing significant development, or because the law of other jurisdictions is in sharp conflict, suggesting the need for a fundamental policy choice. . . . If the federal judge is convinced that the question posed to him is close to a matter of central and continuing state concern, then, he may be justified in invoking the doctrine." Note, *Abstention and Certification in Diversity Suits: "Perfection of Means and Confusion of Goals"*, 73 YALE L. J. 850, 867 (1964).

Thus, under the *Thibodaux* rule federal courts, faced with difficult *Erie* problems in determining state law, will postpone[13] decision in order to

> "prevent possible disparity between the federal version of state law and that which would be later fashioned in state court. This expansion of the abstention doctrine was a logical extension of the principle underlying *Erie* that federal courts must defer to state courts for the formulation of state law." Note, *Inter-jurisdictional Certification: Beyond Abstention Toward Cooperative Judicial Federalism*, 111 U.PA. L. REV. 344, 346 (1963).

See also, Lillich & Mundy, *Federal Court Certification of Doubtful State Law Questions*, 18 U.C.L.A. L. REV. 888, 890 (1971); Note, *Louisiana Power & Light* v. *Thibodaux:*

13. Abstention does not involve the relinquishment of jurisdiction: "This course does not constitute abnegation of judicial duty. On the contrary, it is a wise and productive discharge of it. There is only postponement of decision for its best fruition. Eventually the District Court will award compensation if the taking is sustained. If for some reason a declaratory judgment is not promptly sought from the state courts and obtained within a reasonable time, the District Court, having retained complete control of the litigation, will doubtless assert it to decide also the question of the meaning of the state statute." *Louisiana Power & Light Co.* v. *City of Thibodaux*, *supra*, 29.

The Abstention Doctrine Expanded, 69 YALE L.J. 643, 652 (1960).

It is recognized, moreover, that *Thibodaux* sharply curtailed the force of *Meredith* v. *Winter Haven,* 320 U.S. 228 (1943). *Meredith* was a suit brought by municipal bondholders to prevent the city which issued the bonds from retiring them without making certain interest payments. The Fifth Circuit viewed the state law as unclear and ordered the case dismissed without prejudice to a state court action. This Court reversed, holding that:

> "the difficulties of ascertaining what the state courts may hereafter determine the state law to be do not in themselves afford a sufficient ground for a federal court to decline to exercise its jurisdiction. . . ." *Id.,* 234.

Commentators have questioned the strength of *Meredith* after *Thibodaux,* since

> "[I]t is questionable whether the city's condemnation of property involved in *Thibodaux* was any more closely related to local sovereignty or any more sensitive as a subject of federal-state conflict than the city's program for retiring its bonded indebtedness involved in *Meredith.*" Note, *Judicial Abstention from the Exercise of Federal Jurisdiction,* 59 COLUM. L. REV. 749, 764 (1959).

See also, Gowan & Izlar, *Federal Court Abstention in Diversity of Citizenship Litigation,* 43 TEXAS L. REV. 194, 204 n.62 (1964); Note, *Federal Abstention and its Relation to the Erie Doctrine,* 38 TEMP. L. Q. 72, 76-78 (1964). Even the reputedly strict rule of *Meredith,* later modified in *Thibodaux,* was expressly qualified by the Court's recognition that federal courts ought not to decide questions

purely involving state policy where adequate relief is available in the state system. 320 U.S. at 235-36.[14] In *Meredith*, in any event, abstention was improper since the main state law issue had previously been ruled on, in contrast to the instant case.

In *Thibodaux*, however, there were no Louisiana precedents to guide the federal court, and the lower court's stay was affirmed in that light. What amount of uncertainty in state law calls for abstention is not established, but it is clear that an entire absence of decisions, as here, certainly meets the test. See Note, *supra*, 69 YALE L.J. at 652.

B. This case requires decision of an important issue of Florida's public policy.

The controlling issue in this case involves a serious public policy choice. Whether Florida wishes to break with the common law rule (see Point III, *infra*) and adopt the *Diamond* rule, which has only been accepted in a single state, requires consideration of numerous policy implications. A rule which will enrich Florida corporations with windfall recoveries of unlawful profits made by their own insiders—and indeed by outsiders as well—could create greater conflicts of interest than it seeks to reduce.

Chief Judge Friendly remarked on the paramount state interest in this area in another case which also concerned the duties of corporate fiduciaries and those who act with them:

> "Here we are forced to decide a question of New York law, of enormous importance to all New York corporations and their stockholders, on which there is hardly enough New York authority for a really informed prediction what the New York Court of

14. Accord: *Burford* v. *Sun Oil Co.*, 319 U.S. 315 (1943); *Railroad Commission* v. *Rowan & Nichols Oil Co.*, 310 U.S. 573 (1940).

> Appeals would decide on the facts here presented..." *Essex Universal Corp.* v. *Yates,* 305 F. 2d 572, 580 (CA2 1962) (concurring opinion).

And he urged a decision which would have the least possible impact on the unsettled law of the state and thereby "leave the development of doctrine in the area to the State, which has primary concern for it," *id.,* 582. Notably, Judge Friendly remarked that the difficulty of determining such uncertain state-law policies of "enormous importance" to the state of incorporation had

> "led at least one state to authorize its courts to answer questions about its law that a Federal court may ask." *Id.,* 580 (footnote omitted).

And he cited the Florida provisions, FLA. STAT. ANN. §§ 25.031, 25.032 (1961), which might have been used in this case, but were not.

Very recently, in *Kaiser Steel Corp.* v. *W. S. Ranch Co.,* 391 U. S. 593 (1968), this Court unanimously reversed without argument the action of two lower courts in refusing to abstain pending decision by state courts. *Kaiser* involved the right of a private business to condemn land to gain access to water. That issue, this Court said:

> "is one of vital concern in the arid State of New Mexico, where water is one of the most valuable natural resources. The question, moreover, is a truly novel one. The question will eventually have to be resolved by the New Mexico courts, and since a declaratory judgment action is actually pending there, in all likelihood that resolution will be forthcoming soon. Sound judicial administration requires that the parties in this case be given the benefit of the same rule of law which will apply to all other businesses and landowners concerned with the use of this vital state resource." *Id.,* 594.

Judge Brown, in the Court of Appeals in *Kaiser*, had urged his brethren to abstain, stressing that *Meredith* v. *Winter Haven, supra,* did not compel federal courts to speculate unnecessarily on what the state law was:

> "Thus, *Meredith* v. *City of Winter Haven,* [*supra*], is not, as is so often supposed, an absolute that under every and all circumstances a federal court in a diversity case has to plow through without calling on the state tribunals for aid in the divination of serious and troublesome state problems. Too much has gone on—indeed too much water has gone over the dam—for any such reading to be compelled. Putting to one side *Thibodaux,* in which the Court of Appeals was reversed for failure to abstain for state court determination in a diversity case, the Supreme Court's repeated use of the Florida *Clay* type certification procedure demonstrates that the policy reflected in *Winter Haven* is not a road block. It is simply one of the factors to be assayed." *W. S. Ranch Co.* v. *Kaiser Steel Corp.,* 388 F.2d 257, 263-64 (CA10 1968) (concurring and dissenting opinion; footnotes omitted).

To illustrate his point, Judge Brown cited numerous instances when federal courts had gone wrong in forecasting state law:

> "[R]eal injustice is done to litigants and, worse, more damage is done to the states' jurisprudence and its policies by a headstrong, resolute, inflexible determination on the part of a federal court to barge ahead in a sort of ascetic, misguided *Winter Haven* impulse, than will likely result from the slight delay occasioned by invoking state adjudication of the controlling issues. For the simple fact is that more and more, more federal courts are being overruled by more state courts on local issues upon which such federal courts have undertaken to read the *Erie* signs in the quest of the *Winter Haven* grail.

> "Texas, for example, continues on its path of independence in a number of instances not the least of which was the Fifth Circuit's *Delaney* prediction itself. But, this is not an infirmity of the Fifth Circuit alone. And the experience in Florida demonstrates that state court reversals of Federal appellate decisions occur both in appeals of state cases and on *Clay* certification . . . to the Supreme Court of Florida, the latter with some spectacular results." *Id.*, 264-65 (footnotes omitted).

The Florida decisions led this Judge to conclude that

> "No amount of prescience, including that thought by some to come from a Federal Commission, enables a non-Florida Judge authoritatively to determine Florida policy." *Id.*, 265 n.15.

On certiorari this Court took the course urged by Judge Brown and ordered abstention in *Kaiser*, even though the petitioner had begun its state court action only after it lost in the Tenth Circuit, 388 F.2d at 266. That suit then proceeded, and the state supreme court declared state law to be exactly contrary to the Tenth Circuit's view, *Kaiser Steel Corp.* v. *W. S. Ranch Co.*, 81 N.M. 414, 467 P.2d 986 (1970), thereby preventing a serious injustice.

Merely because, as here, a clash of private commercial interests raises the question does not affect the need to abstain. *Kaiser Steel Corp.* v. *W. S. Ranch Co., supra.* Nor can respondents assert the policy of diversity jurisdiction of preventing prejudice in state courts against out-of-state litigants, since the interest they represent is a Florida corporation. See also Liebenthal, *A Dialogue on England: The England Case, Its Effect on the Abstention Doctrine, and Some Suggested Solutions*, 18 W. RES. L. REV. 157, 180 (1966). And plainly this case involves an issue crucial to the operation of all Florida corporations, in an

area where significant public policy choices have to be made by Florida, and where the law of New York has sharply broken from precedent. Thus, abstention was required.

C. Certification fulfills all the purposes of abstention.

But this case does not even require the usual abstention procedures. The question could easily have been certified direct to the Supreme Court of Florida. Under this procedure the federal court states the issue of law and its factual background in a certificate to the Florida court. The parties to the federal action brief and argue the issue, and the Florida court transmits its answer to the federal court.[15] Such course differs in principle from abstention:

> "It would not seem . . . that the certification procedure is in effect a variation of abstention. . . . The federal courts by taking advantage of a certification procedure do not abnegate their responsibility to decide a diversity case. . . .
>
> "The certification procedure is analogous to a situation in which a federal court temporarily abstains because another case between different parties involving precisely the same issues of state law is pending in the state appellate courts. Certainly this would be proper in a diversity case. . . ." Gowen & Izlar, *supra*, 43 TEXAS L. REV. at 209-10 (footnote omitted).

By certifying an issue, the federal court maintains full control of the litigation:

> "[T]he federal court would not be reduced, in a diversity case, to a 'sterile monitor,' for it would be the basic instrument of the resolution of the entire case in specifying the state law question within the framework of the relevant facts and legal issues to the state's highest authority." Liebenthal, *supra*, 18 W. RES. L. REV. at 201.

15. See FLA. APP. RULES, R. 4.61 (1967); see "Statutes Involved", *supra*, pp. 3-5.

Thus certification permits active cooperation between the state and federal court:

> "Judicial cooperation [under abstention] exists only in the sense that a federal court has deferred to a state court. In inter-jurisdictional certification, however, the federal court actively participates in the resolution of the entire case by framing the state law question, specifying relevant facts and legal issues, and certifying directly to the state's highest court." Note, *supra,* 111 U. PA. L. REV. at 350.

See also Kaplan, *Certification of Questions from Federal Appellate Courts to the Florida Supreme Court and its Impact on the Abstention Doctrine,* 16 U. MIAMI L. REV. 413, 432 (1963).

None of the valid purposes of abstention is hindered by certification:

> "Thus, inter-jurisdictional certification . . . not only achieves the objectives of abstention—to prevent federal invasion of the state law-making function and to avoid needless federal-state friction—, but also represents a more perfect attempt at cooperative judicial federalism, since concern for state sovereignty is implemented through a more efficient and simpler proceeding." Note, *supra,* 111 U. PA. L. REV. at 350.

Certification equips federal courts with the best means to "search for and apply the entire body of substantive law governing an identical situation in the state courts," see *Ruhlin* v. *New York Life Insurance Co.,* 304 U.S. 202, 209 (1938), and to "ascertain from all the available data what the state law is and apply it," see *West* v. *American Telephone & Telegraph Co.,* 311 U.S. 223, 237 (1940):

> "In the Diogenes-like search for 'state law', the federal courts have resorted to the decisions of interappellate courts and even the decisions at nisi

> prius courts. Quite obviously such decisions may be questionable, ill-considered and possibly may not represent the 'state law.' The solution offered by the Florida legislation would obviate resorting to unauthoritative sources to determine the law of the state, and would solve the problem of the search for controlling precedents where none, in fact, exists." Vestal, *The Certified Question of Law,* 36 Iowa L. Rev. 629, 644-45 (1951).

Professor Kurland states that certification offers the "greatest promise" of ensuring equal application of state law:[16]

> "The fourth possibility, offering the greatest promise, is to have the federal intermediate appellate court certify the troublesome question of state law to the state high court for resolution. . . . In this manner, the court best equipped to answer the state law questions could do so in a definitive manner, without the expense of time and resources demanded by a stay of the federal court proceeding pending a declaratory judgment action in the state court. . . . [T]he equality of treatment which the Erie rule was aimed to accomplish would be better assured." Kurland, *Mr. Justice Frankfurter, The Supreme Court and the Erie Doctrine in Diversity Cases,* 67 Yale L. J. 187, 214 (1957).

See also, Note, *Consequences of Abstention by a Federal Court,* 73 Harv. L. Rev. 1358, 1368 (1960).

D. Certification presents none of the practical difficulties of abstention.

The practical objections to abstention are cured by certification. Abstention may deny a party the right to have

16. Another writer concludes concisely that certification solves *Erie* problems

> "by making *certain* the state law which the federal court is to apply." Note, *Federal Jurisdiction—Abstention—Inter-Sovereign Certification,* 48 Iowa L. Rev. 185, 193 (1962) (italics original).

the facts found by a federal court. *England* v. *Louisiana State Board of Medical Examiners,* 375 U.S. 411, 416-17 (1964). But if the state court rules on facts found or stated by a federal court, such objection is obviated:

> "Although a certification procedure is used, it is in the federal court that the fact determinations are made, and it is in there that the law derived from the state court in its certified answer will be applied." Gowen & Izlar, *supra,* 43 TEXAS L. REV. at 210.

See also Currie, *The Federal Courts and the American Law Institute,* 36 U. CHI. L. REV. 310, 317 (1969), Note, *supra,* 73 YALE L. J. at 868-69. The purpose of diversity jurisdiction is fully preserved, although its burdens are markedly diminished:

> "[D]iversity jurisdiction is intended to create only an alternative forum to ensure evenhanded application of state law and unbiased fact finding—by definition not involved in certification since the certificate establishes the factual situation—, rather than to provide a means of avoiding state court interpretation of state law." Note, *supra,* 111 U. PA. L. REV. at 359.

Delay and expense that abstention imposes upon litigants, a matter of concern to this court, see *Baggett* v. *Bullitt,* 377 U.S. 360, 379 (1964); *County of Allegheny* v. *Frank Mashuda Co.,* 360 U.S. 185, 196 (1959), do not follow from certification. The Florida procedure has been described as "[p]robably the best solution to the delay problem", Kurland, *Toward a Co-operative Judicial Federalism: The Federal Court Abstention Doctrine,* 24 F.R.D. 481, 489 (1960). See also H. M. HART & H. WECHSLER, THE FEDERAL COURTS AND THE FEDERAL SYSTEM 1006 (2d ed. 1973).

Since certification has none of the practical disadvantages of abstention, it is called for even when abstention might not be appropriate.

> "The Florida certification device, on the other hand, allows litigants to skirt the lower state courts entirely and to obtain a judgment directly from the highest state court in answer to propounded questions of state law, a procedure which may result in considerable savings of time and expense. . . . Given the speed, authority, and economy possible using certification procedures, abstention under these procedures could tolerably range a far wider scale of state law questions than abstention implemented by declaratory judgment." Note, *supra,* 73 YALE L. J. at 867-69 (footnotes omitted).

See also, Lillich & Mundy, *supra,* 18 U.C.L.A. L. REV. at 908-09; Liebenthal, *supra,* 18 W. RES. L. REV. at 201.

Under the Florida procedure, moreover, the question is resolved in an adversary proceeding with the issues sharply focused and devoid of abstraction. *Id.,* 352; see also, Lillich & Mundy, *supra,* 18 U.C.L.A. L. REV. at 901-02, 904-05; Liebenthal, *supra,* 18 W. RES. L. REV. at 202-03.

E. There is a consensus that certification accords with modern principles of judicial administration.

The National Conference of Commissioners on Uniform State Laws has recommended, and the American Bar Association has approved, a proposed Uniform Rule for the certification of questions of law between jurisdictions.[17] The

17. UNIFORM CERTIFICATION OF QUESTIONS OF LAW [ACT] [RULE], approved and recommended for enactment in all the states by the National Conference of Commissioners on Uniform State Laws, in its conference of July 31 through August 5, 1967, and approved by the American Bar Association at its meeting of August 9, 1967.

accompanying note states that the procedure is specifically addressed to the "very difficult" and "awkward" problem, under *Erie R. R.* v. *Tompkins, supra,* of ascertaining "state law when the state judiciary has not spoken definitively on the matter. The federal courts have been forced to guess what the state law is." *Id.,* 3. Certification is said to be

> "a more rapid method than the use of the abstention doctrine and seems to be a much more orderly way of handling the problem." *Id.*

The note remarks on the frequent use by federal courts of the Florida certification procedure. It urges adoption of a uniform rule, to encourage use of certification:

> "[I]t would seem to be eminently desirable that uniformity be achieved in this area. Uniformity would make probable the greater use of certification." *Id.,* 5.

The proposed Uniform Rule, "patterned in large measure on Florida Appellate Rule 4.61", *id.,* 3 n.2, broadly authorizes certification whenever there are questions of state law "which may be determinative of the cause then pending in the certifying court and as to which it appears to the certifying court there is no controlling precedent . . ." *Id.,* 6, § 1.

It is thus difficult to see why the majority below rejected certification and avoided a decision by Florida of the important public policy issue involved. It is especially inexplicable in light of the fact that one member, and the only judge, on the panel of six lawyers who acted for the National Conference of Commissioners on Uniform State Laws in preparing the Uniform Rule was Circuit Judge Waterman, the author of the majority opinion below.[18]

18. *Id.,* 2.

The American Law Institute has also voted its approval of a proposed codification of certification principles. Like the Uniform Rule, it authorizes certification in a broad range of circumstances.[19]

F. This Court has encouraged use of the enlightened Florida certification procedure.

Recognizing its advantages, this Court has itself employed the Florida procedure three times to date. The Court first did so in *Clay* v. *Sun Insurance Office, Ltd.*, 363 U.S. 207 (1960). Speaking for the Court, Justice Frankfurter praised the procedure:

> "The Florida Legislature, with rare foresight, has dealt with the problem of authoritatively determining unresolved state law involved in federal litiga-

19. ALI, STUDY OF THE DIVISION OF JURISDICTION BETWEEN STATE AND FEDERAL COURTS, TENTATIVE DRAFT No. 6 § 1371(e), at 39 (1968). The proposal provides, in full:

> "(e) A court of the United States may certify to the highest court of a state a question of State law, if (1) the State has established a procedure by which its highest court may answer questions certified from such court of the United States; (2) the question of State law may be controlling in the action and cannot be satisfactorily determined in the light of the State authorities; and (3) the court expressly finds that certification will not cause undue delay or be prejudicial to the parties." *Id.*

The annexed commentary summarizes the advantages of certification over the usual abstention process:

> "Since the question will be certified to the highest state court, many of the delays incident to ordinary abstention orders, which require instituting a declaratory judgment action in a state court and prosecuting it through the state courts, may be avoided. Furthermore, the form of the question certified and the record sent to the state court with the certification are always under the control of the certifying federal court which can better assure that the right question will be answered on the right facts." *Id.*, 214.

> tion by a statute which permits a federal court to certify such a doubtful question of state law to the Supreme Court of Florida for its decision. Fla. Stat. Ann., 1957, § 25.031." *Id.*, 212 (footnote omitted).

Again in *Dresner* v. *City of Tallahassee*, 375 U. S. 136 (1963), and in *Aldrich* v. *Aldrich*, 375 U.S. 75 (1963), the Court used the same means to determine Florida law.[20] Mr. Justice Douglas, concurring in *England* v. *Louisiana State Board of Medical Examiners, supra*, mentioned certification as a procedure to be encouraged to "lighten [the] requirements," *id.*, 432, of abstention:

> "Another alternative is for the District Court to follow the certificate route, where one is available. . . . We use [the Florida] procedure on Florida state law perplexities. . . . We cannot require the States to provide such a procedure; but by asserting the independence of the federal courts and insisting on prompt adjudications we will encourage its use." *Id.*, 433-34.

The Second Circuit, however, sacrificing both comity and certainty, needlessly prevented an authoritative ruling and boldly undertook to decide for Florida "a problem presenting fundamental and serious questions of state policy with only fragmentary case materials with

20. *Clay* was decided on the merits after the certified questions were answered, *Clay* v. *Sun Ins. Office, Ltd.*, 377 U.S. 179 (1964). The answers of the Supreme Court of Florida in *Dresner* enabled the Court to dismiss the writ of certiorari as improvidently granted, *Dresner* v. *City of Tallahassee*, 378 U.S. 539 (1964), and in *Aldrich* the Court reversed on the basis of the answers:

> "Given the answers of the Florida court, it becomes plain that the judgment of the Supreme Court of Appeals of West Virginia, based as it was on a misapprehension regarding the law of a sister State, cannot stand." *Aldrich* v. *Aldrich*, 378 U.S. 540, 543 (1964).

which to work," see *W. S. Ranch Co.* v. *Kaiser Steel Corp., supra,* 388 F.2d at 265 n.15. So doing, it disregarded this Court's decisions requiring abstention and specifically approving the use of the certification procedure. The lower court's rejection of that procedure, without any explanation and over firm dissent, requires review to decide the recurring question of when certification is required. Lehman respectfully suggests that in a similar context Justice Holmes correctly stated the merits of certification, saying that

> "I think that such questions are to be encouraged as a mode of disposing of cases in the least cumbersome and most expeditious way." *Chicago, B. & Q. Ry.* v. *Williams,* 214 U.S. 492, 495-96 (1909) (dissenting opinion).

POINT II

The Decision of the Court of Appeals Conflicts With Decisions in Other Circuits.

The Court of Appeals for the Fifth Circuit frequently uses the Florida certification procedure, as this Court has done, to determine state law. One can thus confidently say that, if this case had arisen in the Fifth Circuit, under that court's settled policy the law would have been determined by the Supreme Court of Florida rather than by the strained "prediction" of two judges below, based on New York law.[21]

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21. The Fifth Circuit routinely uses certification in diversity cases. See, *e.g., Gordon* v. *John Deere Co.,* 451 F.2d 234 (CA5 1971) (retroactivity of long-arm statute); *Allen* v. *Estate of Carman,* 446 F.2d 1276 (CA5 1971) (exclusiveness of workmen's compensation remedy; out-of-state contacts); *A. R. Moyer, Inc.* v. *Graham,* 443 F.2d 434 (CA5 1971) (liability of architects and engineers to con-

In *Hopkins* v. *Lockheed Aircraft Corp.*, 394 F.2d 656 (CA5 1958), upon receipt of the answer from the Supreme Court of Florida, the Fifth Circuit strongly endorsed certification in cases, like this one, requiring difficult policy choices in an area of developing law:

> "The difficulty of this problem transcended that of our usual *Erie* travail. This was so for a number of reasons. The local materials with which to work were meagre. Additionally, there had been elsewhere a considerable change in the outlook on choice of law concepts and, most important, the problem was not so much of trying to ascertain what had been held, as it was divining the policy considerations which the Supreme Court of Florida would now embrace. For policy it surely is.
>
> ". . . For a Federal Court to have attempted to resolve the question on its own would have been fraught with great hazard both to litigants and the law. . . .
>
> "Thus where *Erie* often compels the most speculative anticipation on matters not yet decided, Florida's procedure gives a clear, positive final, decisive answer. . . . It is Florida law binding on us as we perform our *Erie* role.

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tractor for delays due to negligence); *Boyd* v. *Bowman*, 443 F.2d 848 (CA5 1971) (automobile insurance policy coverage); *Trail Builders Supply Co.* v. *Reagan*, 409 F.2d 1059 (CA5 1969) (liability of employer to indemnify third party despite exclusiveness of workmen's compensation remedy as to employee); *Gaston* v. *Pittman*, 405 F.2d 869 (CA5 1969) (tort liability of husband to wife after divorce); *Martinez* v. *Rodriquez*, 394 F.2d 156 (CA5 1968) (defense of mother's contributory negligence to father's suit for wrongful death of child); *Life Insurance Co. of Virginia* v. *Shifflet*, 370 F.2d 555 (CA5 1967) (defense based on negligent misrepresentations in suit on life insurance policy); *Hopkins* v. *Lockheed Aircraft Corp.*, 358 F.2d 347 (CA5 1966) (applicability of state limitation on wrongful death recovery; out-of-state contacts); *Green* v. *Am. Tobacco Co.*, 304 F.2d 70 (CA5 1962) (warranty liability of cigaret manufacturer for death due to cancer); cf. *Moragne* v. *States Marine Lines, Inc.*, 409 F.2d 32 (CA5 1969) (cause of action based on unseaworthiness under wrongful death act).

> "In a workable, administratively efficient and expeditious process all doubt is eliminated, all guess work removed." *Id.*, 656-57 (Footnotes omitted).

In other cases the Fifth Circuit has praised the procedure for saving it "from committing a serious error as to the law of Florida which might have resulted in a grave miscarriage of justice". *Green* v. *American Tobacco Co.*, 325 F.2d 673, 674 (CA5 1963).[22] The Fifth Circuit expressly understands and applies this Court's ruling in *Kaiser Steel Corp.* v. *W. S. Ranch Co., supra,* as authority approving its use of certification. *Martinez* v. *Rodriquez,* 410 F.2d 729, 731 n.5 (CA5 1969).

Unless this Court now intervenes, the clear conflict between the Second and Fifth Circuits and other circuits[23] in

22. See also *United Services Life Ins. Co.* v. *Delancy,* 328 F.2d 483, 486 (CA5 1964), listing several instances in which certification saved the Fifth Circuit from erroneously declaring Florida law.

23. The First Circuit has employed the New Hampshire certification procedure to determine the merits of a statutory defense to a tort action. See, *Ford* v. *Black Mountain Tramways, Inc.*, 110 N.H. 20, 259 A.2d 129 (1969). The Maine certification procedure, available to federal district courts, has been used by the District Court in Maine. See, *Pierce* v. *Secretary,* 254 A.2d 46 (Me. 1969) (validity of common law marriage); In re *Richards,* 223 A.2d 827 (Me. 1966) (certified questions not answered where facts unclear); *Norton* v. *Benjamin,* 220 A.2d 248 (Me. 1966) (bar of general release to indemnity claim in tort action). The American Law Institute Proposal to codify the use of certification for federal courts was adopted on the motion of District Judge Gignoux, see ALI PROCEEDINGS 371-88 (1966).

See also, In re *Elliott,* 74 Wash. 2d 600, 446 P.2d 347 (1968), where the Supreme Court of Washington replied to a certified question from the District Court for the Western District of Washington concerning disposition of life insurance proceeds in insolvency; *Irion* v. *Glens Falls Ins. Co.*, 154 Mont. 156, 461 P.2d 199 (1969), where the Supreme Court of Montana answered a question certified by the District Court for the District of Montana relating to ownership of

the application of this useful procedure will endure. The question is important to the fair and efficient administration of the federal judicial system and will recur in numerous cases to which this Court will be unable to give separate attention. The issue thus requires intervention by writ of certiorari.

POINT III

The court below wrongly decided an important issue of Florida law in disregard of its duties under Erie R.R. *v.* Tompkins, 304 U.S. 64 (1938).

The decision below, as Judge Kaufman's dissent recognized, takes unauthorized liberties with the Florida law. Generally, the "common law rule precludes corporate recovery of profits made by insiders on dealings in the corporation's stock." Note, *Inside Information as a Corporate Asset,* 1970 WIS. L. REV. 576, 577 (1970). No Florida decisions support the proposition that confidential information about a corporation, which that corporation could not lawfully use to gain a profit by selling stock, is an "asset" of the company for use of which company fiduciaries are accountable. Far less does Florida law hold that *any* person who profits from such information, in the absence of any sort of confidential relationship, is accountable to the corporation as a "fiduciary". And *a fortiori* there is no rule that persons who merely transmit such information are liable for some third party's profits.

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an automobile involved in a collision; *cf., Almarez* v. *Carpenter,* 477 P.2d 792 (Colo. 1970), where the Supreme Court of Colorado answered questions of state procedure which arose in a federal question case and were certified by the District Court for the District of Colorado.

There is no such rule even in New York. *Diamond*, a decision "unique both in its reasoning and conclusion," Note, *Common Law Fiduciary Principles Applied in Holding Directors Liable to Corporation for Profits from Corporate Stock Sales Made Because of Inside Information*, 37 FORDHAM L. REV. 477, 478 (1969), "discarded the long standing common law rule that precluded corporate recovery", Note, *supra*, 1970 WIS. L. REV. at 578, but only as to fiduciaries of the corporation. In *Diamond* the New York Court of Appeals said the question before it was

> "whether *officers and directors* may be held accountable to *their corporation* for *gains realized by them* from transactions in the company's stock as a result of their use of material inside information." *Diamond* v. *Oreamuno*, *supra*, 496 (emphasis supplied).

The court thus spoke only of officers and directors. Since Lehman was not an officer or director of Lum's, since it was not an investment advisor or banker to Lum's, and since it had no relationship with Lum's which could be called confidential, there is no basis for calling it a "fiduciary" in order to extract a windfall recovery.

Moreover, Lehman made no profits. *Diamond* itself was dismissed on the *pleadings* against other directors who connived in the sales of stock but made no profits themselves, as the court below realized.[24] Thus, under New York law even fiduciaries are not liable if they make no profits, and Lehman is doubly exempt.

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24. The court below passed over this point, saying that the defendants here were "furthering" (19A n.6) the sales, but it is hard to see how a director could better encourage sales by a fellow director than by nondisclosure and ratification, and it is wholly unclear why such action would not constitute a breach of fiduciary duty. The reason for the exemption of the other directors in *Diamond* is plain: if there are no profits, there is no liability.

Principles derived from Florida cases refute the claims herein. Even where a confidential relationship exists, Florida has only imposed liability for use of information which the entrustor could legally employ for his own gain.[25] Indeed, before *Diamond*, "no common law judicial authority existed," Note, *supra*, 37 FORDHAM L. REV. at 478, for corporate recovery of wrongful gains. Nothing in any Florida decision suggests that Florida is contemplating a rejection of the general rule that

> "[L]iability will not attach if it can be shown that the opportunity *could not be acquired by the corporation* and would not lead to future competition with it. . . . In effect, the corporation will be allowed to recover only when it can be shown that the opportunity *would have been of value to it*." Note, *supra*, 1970 WIS. L. REV. at 581 (emphasis supplied).

The decision below stands this principle on its head. Indeed the cases the majority relies on (21A) instead support Lehman. In *Ohio Oil Co.* v. *Sharp*, 135 F.2d 303 (CA10 1943), the court permitted recovery only on a showing that the business opportunity which the defendant misappropriated had been acquired by his employer in all "good faith", *id.*, 309. And in *Brophy* v. *Cities Service Co.*, 31 Del. Ch. 241, 70 A.2d 5 (1959), which held an insider liable for profits he made by buying stock when he knew the corporation would begin a stock repurchase program, the court took care to note that such corporate purchases were authorized by stat-

25. See, *e.g.*, *Inland Rubber Co.* v. *Helman*, 237 So.2d 291 (Fla. App. 1970) (customers' lists known to former employee); *Whittle* v. *Ellis*, 122 So.2d 237 (Fla. App. 1960) (law practice); *Quinn* v. *Phipps*, *supra* (business opportunity known to agent); *Connelly* v. *Special Road & Bridge District No. 5*, 99 Fla. 456, 126 So. 794 (1930) (same).

ute, *id.*, 7 n.1.[26] These cases reject the idea that a company has an equitable right to profits that it could not rightfully make.

None of the deference given to an interpretation of state law by a judge trained in the local jurisprudence is due to the majority opinion below, for Second Circuit judges cannot be viewed as expert in the law of the remote state of Florida. Compare *Bernhardt* v. *Polygraphic Co.*, 350 U.S. 198, 204 (1956), with *Thompson* v. *Magnolia Petroleum Co.*, *supra*, 481. Rather the case presents an extreme instance of disregard of this Court's admonition, especially to be heeded where important matters of public policy are in issue, that where the state decisions portend no radical development, *Bernhardt* v. *Polygraphic Co.*, *supra*, 205, federal judges are without authority to introduce a novel rule. The departure from that principle by the court below calls for this Court's intervention by writ of certiorari.

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26. Thus *Brophy* does not support *Diamond*, for the insider in *Brophy* appropriated a wholly lawful corporate opportunity: "[H]is liability was based not on the use of inside information, but rather on his competition with the corporation in its acquisition of corporate stock." Note, *supra*, 37 FORDHAM L. REV. at 479.

CONCLUSION

For the reasons set forth above, the petition for a writ of certiorari should be granted and the judgment of the Court of Appeals for the Second Circuit reversed.

Respectfully submitted,

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September 6, 1973

APPENDIX

APPENDIX

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

Nos. 70 Civ. 5733, 71 Civ. 1925 and 4218

JOSEPH GILDENHORN, as Guardian for Carol Ann Gildenhorn,

Plaintiff,

v.

LUM'S INC., *et al.*,

Defendants.

ANTONE F. GREGORIO,

Plaintiff,

v.

LUM'S INC., *et al.*,

Defendants.

JACOB SCHEIN and MARVIN H. SCHEIN,

Plaintiffs,

v.

MELVIN CHASEN *et al.*,

Defendants.

December 15, 1971.

TYLER, *District Judge*

Defendants in these consolidated actions have moved to dismiss plaintiffs' complaints upon the ground that they fail to state a claim upon which relief can be granted. Rule 12(b) (6) F.R. Civ.P. Alternatively, all defendants move this court to stay these actions pending a final determina-

tion in *Sanders* v. *Lum's Inc. et al.*, 70 Civ. 5331, a related action pending before this court. Additionally, the individual defendants move that the complaints be dismissed as against them upon the ground that jurisdiction over their persons has not been obtained. Rules 4(e) and 12(b)(2), F.R.Civ.P.[1]

All three of these suits are derivative actions brought on behalf of Lum's Inc. ("Lum's"), a Florida corporation. Jurisdiction is claimed by virtue of diversity of citizenship. The plaintiffs' complaints are predicated on the same facts as *S.E.C.* v. *Lum's et al.*, 70 Civ. 5280, which is also pending before this court. Briefly stated, plaintiffs' claims are based on defendants' alleged misuse of confidential corporate information. The complaints charge that defendant Melvin E. Chasen, aware as president of Lum's that the firm's 1969 earnings would be lower than had been projected, telephoned from his Florida office to defendant Simon, who is employed in the Chicago, Illinois office of defendant Lehman Brothers, Inc., and told him of the earnings' decline. Simon then transmitted the information to Sit, the portfolio manager at defendant IDS New Dimensions Fund ("Dimensions"), whose offices are in Minneapolis, Minnesota. Sit then conveyed the information to defendant Jundt, a manager and analyst for IDS Variable Payment Fund ("Variable"). It is further alleged that Sit and Jundt then caused Variable and Dimensions to sell their entire holdings in Lum's just before the public announcement of the decline in the 1969 earnings caused the stock to drop several points in trading on the New York Stock Exchange.

1. Defendants Sit and Jundt, apparently unaware that I have already granted their prior motions to dismiss by order dated October 25 of this year, once again seek the same relief. As they are no longer defendants in any of these actions, their applications will not be considered.

Plaintiffs make no argument that any of the federal securities acts would support a claim under the facts of this case. They do argue, however, that a claim for which relief can be granted can be made out under the recent decision of the New York Court of Appeals in *Diamond* v. *Oreamuno,* 24 N.Y.2d 494, 301 N.Y.S.2d 78, 248 N.E.2d 910 (1969). Briefly stated, that case held that corporate officers who learn of a drop in corporate earnings by virtue of their fiduciary positions and sell their shares of corporate stock before publishing information as to the loss will be liable to the corporation for any profits made thereby. Plaintiffs urge that Chasen be found liable under *Diamond* even though it is not alleged that he sold any Lum's stock belonging to him and that the remaining defendants be so held under either a "tippee" or general conspiracy theory.

Three issues, thus, are presented to this court by these motions, the first being a choice of law problem. The defendants argue that under the applicable choice of law provisions, these cases should be decided by Florida law. Plaintiffs oppose and urge that their complaints be tested by New York law in general and by *Diamond* v. *Oreamuno, supra,* in particular. Assuming that *Diamond* would apply, this court would then have to determine whether the complaints herein can state a claim under the holding of that case. Finally, it must be decided whether the activities of the individual defendants fall within any of the provisions of the New York long-arm statute, CPLR § 302(a), so as to allow out of state service to be effected upon them pursuant to CPLR § 313.

In actions where jurisdiction is predicated on diversity of citizenship, this court must apply the choice of law rules of the State of New York. *Klaxon Co.* v. *Stentor Electric Mfg. Co.,* 313 U. S. 487, 61 S.Ct. 1020, 85 L.Ed. 1477 (1941). New York follows the general choice of law principle that the law of the state of incorporation governs the existence

and extent of corporate fiduciary obligations as well as the liability for violations of such obligations. *Hausman* v. *Buckley,* 299 F.2d 696, 703 (2d Cir., 1962) and cases cited therein; *Norte & Co.* v. *Huffines,* 304 F.Supp. 1096, 1110 n.6 (S.D.N.Y., 1968). This rule was expressed in *Diamond* itself when the court stated that as regards the ". . . duties and obligations of directors and officers and their relation to the corporation and its shareholders . . . [t]he primary source of the law in this area ever remains that of the State which created the corporation." *Diamond* v. *Oreamuno, supra,* at 503, 504, 301 N.Y.S.2d at 85, 248 N.E.2d at 915.

The same result would be reached by the "grouping of contacts" approach to choice of law in tort actions as enunciated in *Babcock* v. *Jackson,* 12 N.Y.2d 473, 240 N.Y.S.2d 743, 191 N.E.2d 279 (1963). Under this approach, a New York court will apply the law of the state of the "strongest contacts with the cause of action." *Stockwell* v. *Reynolds & Co.,* 252 F.Supp. 215, 220 n.3 (S. D.N.Y., 1965). It appears from the pleadings that this case centers in Florida rather than in New York. Chasen, a Florida citizen, allegedly received and communicated the information from Florida. Lum's was incorporated, headquartered, and, at least theoretically, damaged in Florida. Most of the other contacts appear to be scattered about the midwest, the only contact with New York being several transactions over the New York Stock Exchange. Additionally, a New York court would give more weight to the Florida contacts under the "governmental interest" theory of choice of law enunciated in *Tooker* v. *Lopez,* 24 N.Y.2d 569, 301 N.Y.S.2d 519, 249 N.E.2d 394 (1969), because Florida has the paramount interest in defining and enforcing fiduciary obligations owing to corporations incorporated and doing business within its borders. Accord-

ingly, I find that under any conceivable test, a New York court would apply Florida law to this case.

Under present Florida case law, a plaintiff in a derivative action must prove that the corporation has been damaged by the alleged breach of fiduciary trust. Although the highest court in that state has apparently not considered the matter, several District Courts of Appeal have held on various occasions that a complaint which fails ". . . to indicate both wrongful acts and damage to the corporation" must be dismissed. *Palma* v. *Zerbey,* 189 So. 2d 510, 511 (Fla.App., 1966), cert. denied 200 So.2d 814. (and cases cited therein.)

While it is apparently required that the damage to a corporation be alleged, the Florida cases shed no light on the specificity required for pleading corporate damage. Thus, though the Gildenhorn and Gregorio complaints might be insufficient under Florida law for failing to allege any damage to the corporation at all, the Schein complaint, which contains only a bare allegation that Lum's was damaged, might conceivably be held to be sufficient by a Florida court. Furthermore, I am not unmindful of the possibility that, were a Florida court to hear this case, *Diamond* v. *Oreamuno, supra.,* would be argued to it. Because of the possibility that the *Diamond* rationale might be followed in Florida, it is desirable that this court determine whether these complaints state a claim under *Diamond* for which relief can be granted.

It is clear that the complaints in these actions go far beyond the narrow holding of *Diamond.* In that case, the New York Court of Appeals held that a corporate fiduciary is liable for profits which he realizes from a sale of stock motivated by inside information received by him in his corporate position. None of the defendants in these actions fit into this mold. Chasen, as president and chief operating officer of Lum's, was certainly a fiduciary of that corpo-

ration. None of the complaints, however, allege that he did anything more than pass the inside information to defendant Simon, and there are no allegations that Chasen sold any of his Lum's stock or derived any gain, monetary or otherwise, from the sales that ultimately occurred. On the other hand, the mutual fund defendants would have profited if, as alleged, they sold their 83,000 shares of Lum's stock on the basis of Chasen's inside information. It can scarcely be maintained, however, that the mutual fund defendants were officers or directors of Lum's or owed any fiduciary duties whatsoever to that corporation. The broker-dealer defendants fail to come within either of the *Diamond* perimeters as they were not fiduciaries of the corporation and, did not profit by virtue of the sales.

Plaintiffs, of course, urge a more expansive view of *Diamond*. They point to portions of the opinion indicating that the purpose of the holding was to protect the corporation's interest in ". . . maintaining a reputation of integrity, an image of probity, for its management and in insuring the continued public acceptance and marketability of its stock." *Diamond* v. *Oreamuno, supra,* at 499, 301 N.Y.S.2d at 82, 248 N.E.2d at 912. Thus, say plaintiffs, if the purpose of *Diamond* is to maintain a corporation's integrity on the securities exchanges, it should make no difference whether an officer or director sells his own stock or passes the inside information to others who in turn sell their stock and profit thereby. While the harm done to the corporation might be equal in either instance, there is evidence that *Diamond* was not intended to cover the latter situation. As Chief Judge Fuld explained, the purpose of that derivative action was to allow individual shareholders to be ". . . 'private Attorney General[s]' to . . . enforce proper behavior on the part of corporate officials." *Diamond* v. *Oreamuno, supra,* at 503, 301 N.Y.S.2d at 85, 248

N.E.2d at 915. It is implicit that the jurisdiction of these "private attorney generals" would be limited to the corporation in which they are shareholders. It could not, with any logic, be extended in a derivative action to cover outside individuals, corporations, or institutions who are subject to other private and governmental restraints on their behavior. Furthermore, in affirming the dismissal of the *Diamond* complaint against other board members who were alleged to have aided the defendants in concealing their activities, the New York Court of Appeals made it quite clear that *Diamond* extends only to corporate fiduciaries who actually profit by inside information and does not cover aiders and abettors and/or conspirators. In view of the fact that the New York Court of Appeals could not bring itself to find liability for inter-corporate conspirators, I fail to perceive how this court could extend *Diamond* to cover extra-corporate conspirators and tippees. Accordingly, I conclude that with regard to all defendants save Chasen, the complaints herein fail to state a claim for which relief can be granted.

On the other hand, Chasen, as a corporate officer, might well come within the *Diamond* holding. Although it could be plausibly argued that *Diamond* would not apply to Chasen because of the failure to allege that he sold any stock and profited thereby, it might also be maintained that a New York court could find liability in light of the numerous statements in *Diamond* to the effect that the purpose of the holding is to prevent corporate misfeasance. This question, however, need not be reached because service of process upon Chasen was improper.

In diversity actions, this court's jurisdiction is determined by the law of the State of New York. Rule 4(d)(7), F.R.Civ.P. Because Chasen is not a New York resident and was not served in New York, jurisdiction of his person depends on the New York long-arm statute, CPLR

§ 302(a). It is plaintiffs' assertion that jurisdiction was obtained over Chasen because he set in motion events which culminated with the alleged sale of 83,000 shares of Lum's stock over an exchange located in New York. While I am aware that the scope of CPLR § 302(a) has been broadly construed, I fail to see how it can be read to cover the facts in this case.

While it is settled that one can "transact business" within the meaning of CPLR § 302(a) (1) through an agent, *Parke-Bernet Galleries, Inc.* v. *Franklyn,* 26 N.Y.2d 13, 308 N.Y.S.2d 337, 256 N.E.2d 506 (1970), a New York court would decline jurisdiction of a defendant who merely telephones a single order from outside the state. *Katz & Son Billiard Prods.* v. *Correale & Sons,* 20 N.Y.2d 903, 285 N.Y.S.2d 871, 232 N.E.2d 864 (1967). It seems obvious that Chasen, who did not place the order to sell the Lum's stock in question, did not "purposefully" avail himself "of the privilege of conducting activities" within New York, thereby "invoking the benefits and protections of its laws." *Hanson* v. *Denckla,* 357 U.S. 235, 253, 78 S.Ct. 1228, 1240, 2 L.Ed.2d 1283 (1958).

Plaintiffs next argue that the sale of stock over a national exchange in New York was a "tortious act within the state" and that jurisdiction could be found under CPLR § 302(a) (2). While such a sale will confer jurisdiction in some cases, *Cooper* v. *North Jersey Trust Co. of Ridgewood, New Jersey,* 250 F.Supp. 237 (S.D.N.Y., 1965), CPLR § 302(a) (2) can apply only where the non-resident defendant committed the tort in New York. That the alleged tort here may have been completed or "came to rest" in New York will not confer jurisdiction unless the acts or omissions complained of also occurred in New York. *Feathers* v. *McLucas,* 15 N.Y.2d 443, 261 N.Y.S.2d 8, 209 N.E.2d 68 (1965). *Cooper* v. *North Jersey Trust Co. etc.,*

supra, is not inconsistent as the defendants in that case were physically in New York when they allegedly committed the tort there in issue. As it is nowhere alleged that Chasen committed a tortious act in New York, no jurisdiction of his person can be claimed under CPLR § 302(a) (2).

Finally, there can be no jurisdiction under CPLR § 302(a) (3). As the statute clearly states, the tortious act must cause injury to persons or property in New York. Insofar as none of the non-resident plaintiffs in these cases have alleged that any injury occurred in New York, their invocation of this provision is futile.

Defendant Chasen's motion to dismiss is granted on the ground that no jurisdiction was ever obtained of his person. Rule 12(b) (2) F.R.Civ.P. The motions of the remaining defendants to dismiss under Rule 12(b) (6) F.R.Civ.P. are hereby granted. In view of these rulings, defendants' alternative motion for a stay of these actions need not be reached.

Settle orders accordingly.

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

70 Civil 5733 HRT

JOSEPH GILDENHORN, as Custodian for CAROL ANN GILDENHORN,

Plaintiff,

against

LUM'S INC., *et al.*,

Defendants.

71 Civil 1925 HRT

ANTONE F. GREGORIO,

Plaintiff,

against

LUM'S, INC., *et al.*,

Defendants.

71 Civil 4218 HRT

JACOB SCHEIN and MARVIN H. SCHEIN,

Plaintiff,

against

MELVIN CHASEN, *et al.*,

Defendants.

Defendants Investors Diversified Services, Inc., IDS New Dimensions Fund, Inc., and Investors Variable Payment

Fund, Inc., having moved to dismiss the complaints and the amended complaint in the above entitled actions under Rule 12(b) of the Federal Rules of Civil Procedure and the defendants Benjamin Simon, Lehman Brothers, Lum's, Inc., and Melvin Chasen having joined in said motion and said motions having come on to be heard before the Honorable Harold R. Tyler, United States District Judge, on November 19, 1971, and the Court having considered the papers submitted on said motions, having heard argument of counsel, and having issued an Opinion dated December 15, 1971 granting said motions, it is hereby

ORDERED that the above entitled actions be and they hereby are dismissed with prejudice, and without costs.

Dated: New York, New York
January 5, 1972

H. R. TYLER, JR.
U.S.D.J.

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 81 and 82—September Term, 1972.

(Argued October 17, 1972 Decided May 10, 1973)

Docket Nos. 72-1373, 72-1375

JACOB SCHEIN and MARVIN H. SCHEIN,
Plaintiffs-Appellants,

v.

MELVIN CHASEN, INVESTORS DIVERSIFIED SERVICES, INC., LEHMAN BROTHERS, INVESTORS VARIABLE PAYMENT FUND, INC., BENJAMIN SIMON, IDS NEW DIMENSIONS FUND, INC., EUGENE S. SIT, JAMES R. JUNDT, and LUM'S, INC.,
Defendants-Appellees.

ANTONE F. GREGORIO, individually and as representative of all persons similarly situated as a class under Rule 23, F.R.C.P.,
Plaintiff-Appellant,

v.

LUM'S, INC., MELVIN CHASEN, LEHMAN BROTHERS, BENJAMIN SIMON, INVESTORS DIVERSIFIED SERVICES, INC., EUGENE S. SIT, and JAMES R. JUNDT,
Defendants-Appellees.

Before:

WATERMAN, SMITH and KAUFMAN,
Circuit Judges.

Invoking the diversity jurisdiction of the court, plaintiffs in three cases consolidated below sued derivatively in United States District Court for the Southern District of New York, Tyler, *J.*, alleging that defendants were jointly and severally liable under state corporation law for the profits realized by the defendants Mutual Funds through their trading on the New York Stock Exchange in derivative defendant's stock on the basis of non-public material inside information. An order granting summary judgment was granted to defendants and in two of the consolidated actions the parties have argued appeals.

Reversed and remanded for further proceedings consistent with this opinion.

WATERMAN, *Circuit Judge:*

Plaintiffs-appellants are stockholders in Lum's, Inc., a Florida corporation primarily engaged in restaurant franchising. Invoking the diversity jurisdiction of the court, they sued derivatively in the Southern District of New York alleging that the defendants were jointly and severally liable to Lum's for actionable wrongs which the defendants had committed against Lum's. The individual defendants were Melvin Chasen, a resident of Florida, president of Lum's, Benjamin Simon, a stockbroker employed in Chicago, Ill. by defendant Lehman Brothers, Eugene S. Sit, portfolio manager of defendant IDS New Dimensions Fund, Inc., a Mutual Fund, and James R. Jundt, manager of defendant Investors Variable Payment Fund., Inc., a Mutual Fund. Each of the four individual defendants moved for dismissal on the ground that they had not been validly served under the New York Long Arm Statute (CPLR §§ 313, 302(a)) and that the court below had no personal jurisdiction of them. Sit's and Jundt's motions were granted prior to the filing of the

order appealed from, Chasen's was granted concurrently therewith, and Simon's has apparently not been acted upon.[1] The defendants Lehman Brothers, a partnership engaged in stock brokerage and investment counseling, the three corporations, engaged in managing investment portfolios and in buying and selling the corporate securities of publicly held corporations, Chasen, and Simon, all moved for dismissal on the ground that the complaints failed to state a cause of action under Florida law. Plaintiffs claimed that New York law should govern the rights and liabilities of the parties, and that even if Florida law were the applicable law they should still prevail. Holding that Florida law was the proper state law to apply, Judge Harold R. Tyler, Jr., by written order, *sub nom Gildenhorn* v. *Lum's, Inc.,* opinion reported at 335 F.Supp. 329 (SDNY 1971), granted the motion to dismiss for failure to state a claim upon which relief could be granted.

On this appeal plaintiffs claim only that Judge Tyler erred in dismissing the complaints for failure to state a cause of action.[2] They do not appeal Judge Tyler's order dismissing Chasen as a defendant or his finding that the substantive law of Florida governs the action.[3] Inasmuch

[1] Plaintiffs-appellants have not appealed the order dismissing the actions against Chasen, Sit and Jundt. Simon filed a similar dismissal motion but the trial court did not decide it. Simon was dismissed as a defendant by the court's order dismissing the complaints against all defendants for failure to state a cause of action under 12(b)(6) of the Fed. R. Civ. P. Simon contends on this appeal that irrespective of our action on the lower court's dismissal of the complaints under 12(b)(6), we should dismiss the action against him because he has not been validly served. However, inasmuch as the trial court has not reached this question, we decline to address it on this appeal, and leave its resolution to the trial court upon remand.

[2] In one of the original actions consolidated below, *Gildenhorn* v. *Lum's, Inc.,* 335 F.Supp. 329 (SDNY 1971) a notice of appeal was filed by plaintiff but the parties have not progressed the appeal.

[3] The parties now agree that the substantive law of the State of Florida governs the action for reasons which are stated in Judge Tyler's opinion reported at 335 F.Supp. 329 (SDNY 1971).

as the court is passing only upon the sufficiency of the complaints, we necessarily accept the allegations of the complaints as true. For reasons which follow, we hold that the complaints do state a cause of action and we reverse the judgment below and remand to the district court for further proceedings there in the light of this holding.

The facts alleged in this case fall within the perimeter of the much-discussed problem of unfair trading in corporate securities. In November of 1969 Chasen, who was president and chief operating officer of Lum's addressed a seminar of about sixty members of the securities industry with reference to Lum's earnings prospects for its fiscal year ending July 31, 1970. He informed them that Lum's earnings would be approximately $1.00 to $1.10 per share. On January 5, 1970 he learned that this estimate was too optimistic and that, in fact, Lum's earnings would be only approximately $.76 per share. Three days later, prior to announcing the information to the public, Chasen telephoned Simon in Chicago and told Simon that Lum's would not have as profitable a year as had been expected. He specified to Simon that earnings would be approximately $.76 per share rather than the $1.00 per share which he had earlier announced. Simon knew the information was confidential corporate property which Chasen had not given out publicly. Simon immediately telephoned this information to Sit, an employee of defendant Investors Diversified Services, Inc. (IDS),[4] and Sit immediately telephoned it to Jundt, another employee of IDS. Sit and Jundt managed the stock portfolios of defendant mutual funds Investors Variable Payment Fund, Inc. (Investors) and IDS New Dimensions Fund, Inc. (Dimensions). Upon receiving the

[4] Defendant IDS is a Minnesota corporation licensed to do business in the State of New York. IDS is the distributor and investment advisor for a number of large mutual funds including defendants Investors and Dimensions. Sit and Jundt are employed by IDS to manage the stock portfolios of Investors and Dimensions.

information Sit and Jundt directed the Funds to sell their entire stock holdings in Lum's and, on the morning of January 9, 1970, prior to any public announcement, Investors sold 43,000 shares of Lum's and Dimensions sold 40,000 shares. The sales were executed on the New York Stock Exchange at about 10:30 A.M. at a price of approximately $17.50 per share. At 1:30 P.M. on the same day, the New York Stock Exchange halted further trading in Lum's stock pending a company announcement. At 2:45 P.M. Lum's issued a release which appeared on the Dow Jones News Wire Service and announced that the corporation's projected earnings would be lower than had been anticipated. When trading in Lum's was resumed on Monday, January 12, 1970, volume was heavy and the stock closed at a price of $14.00 per share—$3.50 per share lower than the Funds had realized from the sales of their shares on the previous Friday.

The present defendants in this case are Lehman Brothers, Simon, and the two Mutual Funds. Chasen, Sit, and Jundt have been dismissed as defendants in that they have not been validly served under the New York State Long Arm Statute. Plaintiffs-appellants' theory of recovery is that the participants in this chain of wrongdoing are jointly and severally liable to the corporation under Florida law for misusing corporate information to their own advantage in violation of the duty they owed to Lum's, and that they must account to Lum's for the profits realized by the Mutual Funds. They do not allege in these complaints that defendants have violated any of the federal securities laws,[5] and they concede that the substantive law

[5] Lum's could apparently not prevail as a plaintiff in a Rule 10b-5 action in that it has not traded in its securities on its own account. See *Birnbaum* v. *Newport Steel Corporation*, 193 F.2d 461 (2 Cir. 1952), cert. denied, 343 U.S. 956 (1952). Although there are federal securities law cases pending against defendants in district court, this fact is irrelevant upon this appeal.

of Florida governs the rights and liabilities of the parties. They urge, however, that inasmuch as there are no Florida cases directly in point, the Florida court, if it were deciding the case, would look to other jurisdictions and would take a particular and special interest in the decision of *Diamond* v. *Oreamuno*, 29 A.D.2d 285, 287 N.Y.S.2d 300 (1st Dep't 1968), *aff'd* 24 N.Y.2d 494, 301 N.Y.S.2d 78 (1969), a case which plaintiffs contend supports the position they urge on this appeal.

The first question which our court must consider is whether we may look to the New York decision of *Diamond*, *supra*, as persuasive authority. Ideally, the federal court sitting in a diversity action applies the applicable state law as it has been enunciated by the highest court in the state. *Erie R. Co.* v. *Tompkins*, 304 U.S. 64 (1938); *Hausman* v. *Buckley*, 299 F.2d 696 (2 Cir. 1962), *cert. denied*, 369 U.S. 885 (1962). However, in the absence of a clearly enunciated state rule, the federal court may turn to the law of other jurisdictions for assistance in determining how the state court would most likely decide the case if the state court were presented with the questions being litigated in the federal court. *Baxter* v. *Lancer Industries, Inc.*, 213 F.Supp. 92 (EDNY 1963), *app. denied*, 324 F.2d 286 (2 Cir. 1963); *Locke Manufacturing Companies* v. *United States*, 237 F.Supp. 80 (D. Conn. 1964). Our foray into the state law of Florida satisfies us that the Florida court has never faced the precise issues which are present in this action. Accordingly, it is both proper and practical for this court to turn for guidance to the body of law of other jurisdictions and particularly to that of New York where the resolution of the issues in the *Diamond* case, decided by the New York Court of Appeals, bears on the issues in the case before us. In doing so, our objective is to interpret *Diamond* as the Florida court would probably interpret it and

to apply *Diamond*, as so interpreted, to the facts presented here.

Diamond v. *Oreamuno, supra,* was a stockholder's derivative action in which a shareholder of Management Assistance, Inc. (MAI) charged that two of the defendants—Oreamuno, chairman of the board of directors, and Gonzales, its president and a member of the board, had used inside information acquired by them solely by virtue of their positions with MAI in order to reap large personal profits from the sale of MAI shares, and that these profits rightfully belonged to the corporation. Chief Judge Stanley Fuld, writing for a unanimous court, held that the two directors must account to the corporation for their profits for they had breached their duty to the corporation by using a corporate asset for their own personal advantage.

In this case we are asked to decide whether the *Diamond* holding should extend to reach third parties who, though not officers or directors of the injured corporation, are involved with directors in a common enterprise to misuse confidential corporate information for their own enrichment. Although there is no allegation in the complaints that a prior explicit agreement existed between Chasen and the defendants, it is obvious that the sequence of events detailed in the pleadings, if proved, will substantiate the existence of a common enterprise pursuant to which Chasen was to pass material information to Simon, Simon was to pass it to the Mutual Funds, and the Funds were to capitalize on it by selling Lum's stock prior to the time the material information was announced to and was available to the public. Cf. *American Tobacco Co.* v. *United States,* 328 U.S. 781 (1946); *Interstate Circuit, Inc.* v. *United States,* 306 U.S. 208 (1939); *Norfolk Monument Company* v. *Woodlawn Memorial Gardens, Inc.,* 394 U.S. 700 (1969). Although defendants do not deny that they have been involved in a joint enterprise with Chasen to misuse corpo-

rate property, they argue that the doctrine of *Diamond* is not applicable here and that they cannot be held liable to Lum's because they are not Lum's fiduciaries and have not breached any duty which they owed to Lum's by cashing in on confidential information for their own advantage. Defendants Simon and Lehman Brothers make the further argument that it would be "unfair" to hold them responsible for the profits made by the Mutual Funds in that they (Simon and Lehman Brothers) did not profit personally inasmuch as neither of them traded in Lum's stock.

As a court of equity viewing the case as the Florida court would probably view it, we cannot agree that the "stretch" of *Diamond* does not reach the defendants in this case. We find nothing in the language of *Diamond* to suggest that co-venturers of the director who breaches his duty should not be subject to the same liabilities as those of the director himself for the misuse of corporate information.[6] Indeed, the general rule has always been that "one who knowingly participates in or joins in an enterprise whereby a violation of a fiduciary obligation is effected is liable jointly and severally with the recreant fiduciary." *Oil & Gas Ventures—First 1958 Fund Ltd.* v. *Kung,* 250 F.Supp. 744 (1966); see, *e.g., Jackson* v. *Smith,* 254 U.S. 586, 589 (1921); *Sexton* v. *Sword S.S. Line Inc.,* 118 F.2d 708, 711 (2 Cir. 1941); *Bankers Life and Casualty Co.* v. *Kirtley,* 338 F.2d 1006, 1013 (8 Cir. 1964). If the *Diamond* court had intended to lay down an exception to this well-

[6] We believe Judge Tyler erred in attaching dispositive significance to the fact that in *Diamond,* supra, the complaint was dismissed against certain directors who had only "acquiesced" in the wrong. The defendants-appellees here differ from the dismissed *Diamond* defendants in that the defendants-appellees were actively engaged in furthering the transaction that resulted in the "dumping" of the Lum's stock, rather than just "acquiescing" in it. Furthermore, and even more importantly, *Diamond* was not a "joint venture" case, and there is no discussion in the *Diamond* opinion as to why the complaint was dismissed against the "acquiescing" directors.

known general rule it could have done so in its opinion. Moreover, in the light of the corporate interest which the *Diamond* rule is designed to protect, it is immaterial to the preservation of that interest whether the director trades on his own account in the corporation's stock or whether he passes on the information to outsiders who then trade in the corporation's stock. In either event, so long as the director is involved, the prestige and good will of the corporation may be tarnished by the public revelation that the director has been involved in unethical conduct. *Diamond, supra* at 499; accord, *S.E.C.* v. *Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1308 (2 Cir. 1971), *cert. denied*, 404 U.S. 1005, *reh. denied*, 404 U.S. 1064 (1972). Accordingly, it would be self-defeating to limit the reach of *Diamond* to directors and officers of the injured corporation who have so acted while permitting third-party co-venturers of theirs to escape liability to the corporation.

Diamond, the law of the jurisdiction in which the New York Stock Exchange is seated, has the prophylactic effect of providing a disincentive to insider trading. It is clear that this cleansing effect ought to reach third parties who, through a breach of a fiduciary relationship, become traders advantageously possessed of confidental insider knowledge. To immunize such third parties from liability to the damaged corporation would encourage insider "leaks" to outside friends and would defeat *Diamond's* purpose and effect. And, quite properly, damages for fiduciary breaches are recoverable by recourse to state law. Indeed, though the congressional policy is similar, in some cases where federal private and governmental Rule 10b-5 actions are impractical, "immunized outsiders" might escape liability altogether except for the availability of this kind of action bottomed upon the well-recognized liability of a fiduciary to those whose trust in the fiduciary has been tragically

misplaced. In view of the strong desirability of tightening the law of insider trading, we would be remiss indeed if we interpreted *Diamond* as narrowly as defendants would have us interpret it. Moreover, sitting as a court of equity, we have here an obligation to determine where the equities lie among all the litigants, *Diamond, supra* at 498, and, as between the defendants and Lum's, there can be no doubt that it would be inequitable to permit the defendants to keep the rewards of the fraud.[7]

Our view that all the participants in the common enterprise must assume the same risks of liability to the corporation as the offending director is supported by Florida case law dealing with the duty of a fiduciary to his cestui. The Florida courts have held that the duty of a fiduciary not to misuse the property of his cestui extends not only to the "technical fiduciary" but also to others who are placed in a position of trust. *Quinn* v. *Phipps*, 93 Fla. 805, 113 So. 419 (1927). The confidential relationship of a fiduciary as that relationship is spelled out in Florida law extends not only to "technical fiduciaries" but also to others who become "fiduciaries" through the acquisition of confidential information which is "owned" by someone else. See *Quinn* v. *Phipps, supra* at 420-421. When the defendants received their "tip" from Chasen, they were automatically clothed with a duty to Lum's not to use the information for their own selfish advantages. Compare *Brophy* v. *Cities Service Co.*, 31 Del. Ch. 241, 70 A.2d 5 (1949); *Ohio Oil Co.* v. *Sharp*, 135 F.2d 303 (10 Cir. 1943).

[7] This principle has been applied in analogous cases involving violations of the federal securities laws. In more than one instance, the corporation whose stock has been illegally traded has been permitted to recover conditionally in a Rule 10b-5 action because it is more equitable for it to recoup the rewards of the fraud than for the insider who profits by misusing corporate information to keep them. See *Securities and Exchange Commission* v. *Texas Gulf Sulphur*, 446 F.2d at 1308; *S.E.C.* v. *Golconda Mining Company*, 327 F.Supp. 257 (SDNY 1971).

This is firmly grounded in law and the rule is set forth in the American Law Institute's Restatement of Agency 2d § 312 (1958): "A person who, without being privileged to do so, intentionally causes or assists an agent to violate a duty to his principal is subject to liability to the principal." And see Comment c to § 312:

> A person who, with notice that an agent is thereby violating his duty to his principal, receives confidential information from the agent, may be enjoined from disclosing it and required to hold profits received by its use as a constructive trustee. * * * *

Therefore, if plaintiffs can prove their allegations, it would seem that liability of the Mutual Funds to Lum's must necessarily follow. Be that as it may be, however, the defendants Lehman Brothers and Simon contend that it would be inequitable to apply the rule to them because they did not personally profit by trading in Lum's stock and they hold no profits as constructive trustees of that corporation. Nevertheless, Lehman Brothers and Simon obviously misused inside information as much as Diversified and Investors misused it, and therefore we fail to see how equity would be furthered by imposing liability only on the Funds and not on the other participants who supplied the Funds with the inside information. It is well established that the liabilities of persons engaged in a joint enterprise to commit a wrong are both joint and several liabilities and each participant is liable to account for the profits of the other participants. *Marcus* v. *Otis,* 168 F.2d 649 (2 Cir. 1948), *modified,* 169 F.2d 148 (2 Cir. 1948); *Solomon* v. *United States,* 276 F.2d 669 (6 Cir. 1960), *cert. denied,* 364 U.S. 890 (1960), *reh. denied,* 364 U.S. 939 (1961). Accordingly, we hold that it would be proper to hold Lehman Brothers and Simon just as accountable for

the profits made by their tippees Diversified and Investors as the tippees themselves.[8]

Defendants also contend that the complaints are presently insufficient because they fail to allege with sufficient particularity the damages Lum's is claimed to have suffered. This contention is without merit. Although the Gregorio complaint fails to allege any damages to Lum's, the Schein complaint contains a general allegation of damages, and we find nothing in Florida law to require anything more than a general ad damnum allegation.[9]

Defendants also urge that inasmuch as there are private Rule 10b-5 class actions for damages, *e.g., Sanders* v. *Lum's, Inc., et al.*, 70 Civ. 5331 (SDNY) and an administratve suit brought by the Securities and Exchange Commission, *SEC* v. *Lum's, et al.*, 70 Civ. 5280 (SDNY), pending in federal district court, defendants might be subjected to multiple liability if they are forced to remit to Lum's the profits the Mutual Funds made on their January 9 sales. Since appel-

[8] In passing we note decisions dealing with violations of the federal securities laws which involve the imposition of liability on defendants who have occupied statuses similar to the statuses occupied by defendants in this case. Thus, in *Securities and Exchange Commission* v. *Texas Gulf Sulphur*, 446 F.2d at 1308, the same argument raised by Simon and by Lehman Brothers was raised by defendant Darke. This court held that Darke was liable as a tippor for the profits realized by his tippees. Furthermore, "tippee liability," which is analogous to the liability being imposed upon Diversified and Investors, has been established in federal cases involving violations of the securities laws. See *Ross* v. *Licht*, 263 F.Supp. 395 (SDNY 1967); *In the Matter of Cady, Roberts & Co.*, 40 S.E.C. 907 (1961).

[9] We find it unnecessary to decide whether the defendants could prevail if *neither* complaint alleged damages to Lum's. We point out, however, that Florida law is not clear on the question and *Diamond* holds specifically that an allegation of damages is not a prerequisite to a recovery. *Diamond* v. *Oreamuno, supra* at 499. The case cited by defendants for the proposition that damages must be alleged (*Palma* v. *Zerbey*, 189 So.2d 510 (Fla.App. 1966), cert. denied, 200 So.2d 814 (Fla. 1967)) is a one paragraph per curiam opinion of a lower Florida court, the Florida District Court of Appeals which, inasmuch as it fails to provide a discussion of the issues, we find to be totally unpersuasive.

lees are fully aware of these federal court actions they are well able to protect themselves from multiple liability.[10]

Preventing those who are privy to confidential inside information from using it to their own advantage has found expression in numerous cases in the federal courts dealing with violations of the federal securities laws. See *Securities and Exchange Commission* v. *Texas Gulf Sulphur,* 401 F.2d 833 (2 Cir. 1968), *cert. denied sub nom. Coates* v. *SEC,* 394 U.S. 976 (1969); *List* v. *Fashion Park, Inc.,* 340 F.2d 457 (2 Cir. 1965), *cert. denied,* 382 U.S. 811 (1965); *Wohl* v. *Blair & Co.,* 50 F.R.D. 89 (SDNY 1970); *Ross* v. *Licht,* 263 F.Supp. 395 (SDNY 1967); *Speed* v. *Transamerica Corp.,* 99 F.Supp. 808, 828-829 (D.Del. 1951), *aff'd* 235 F.2d 369 (3 Cir. 1956).

Accordingly, as to those persons found to be within the jurisdiction of the court, we reverse the order appealed from and remand the case for such further proceedings below as may be consistent with the contents of this opinion.

KAUFMAN, *Circuit Judge* (dissenting):

In my view, it is no longer debatable that trading on inside information merits universal condemnation.[1] The undesirable nature of "insider trading" is reflected in the prophylactic provisions of Section 16(b) of the Securities Exchange Act of 1934 and the more general antifraud principles of Section 10b of that Act. I fully agree with Judges Waterman and Smith that one with access to material inside information concerning a corporation's affairs who

[10] See, for example, the method employed in *Securities and Exchange Commission* v. *Texas Gulf Sulphur Co.,* 312 F.Supp. 77, 93 (SDNY 1970), *aff'd in part, rev'd in part,* 446 F.2d 1301 (2 Cir. 1971), cert. denied, 404 U.S. 1005 (1971), reh. denied, 404 U.S. 1064 (1971).

[1] But for a contrary view, *see* H. Manne, Insider Trading and the Stock Market (1966).

knowingly purchases or sells that corporation's shares before this information has become publicly available takes unfair advantage of unknowledgeable parties to the transaction. Indeed, the factual claims contained in the complaints before us have led to two federal actions—an SEC injunctive action and a private class action under rule 10b-5—now pending in the District Court for the Southern District of New York. But the adage that hard facts make bad law is about to come true here, despite Judge, later Justice, Cardozo's warning that judges are not free agents roaming at will to create law to fit the facts. *See* The Nature of the Judicial Process 141 (1921). In the absence of any viable precedent upon which to base the totally new concept of law espoused by my brothers, it is clear that they announce an extraordinary, expansive, and incorrect reading of New York law solely because of their urge to "provid[e] a disincentive to insider trading." I agree with their objective but I question the means employed.

The court holds today that a person with no relationship whatsoever—fiduciary or otherwise—to a corporation, who trades its shares on the basis of material inside information becomes, *ipso facto,* a fiduciary of the corporation whose shares he traded and, accordingly, may be required in a *shareholders' derivative action*—not a Section 10(b) or 16(b) action—to pay his profits to the corporation. With all due respect to my brothers, the tortured reasoning to which they are compelled to resort in reaching this conclusion represents a distortion of the law of agency and the law of fiduciary responsibility in which I am unable to join. Accordingly, I dissent.

Stripped of excess verbiage, the complaints in the two consolidated stockholders' derivative actions before us make the following allegations. In January, 1970, Melvin Chasen, president of Lum's, learned that an earnings estimate of between $1.00 and $1.10 per share previously released to the

financial community was grossly inaccurate. A more realistic figure was $.76 per share. Chasen revealed this information on January 8, during a telephone conversation, to Benjamin Simon, an employee in Lehman Brothers Chicago office. Simon, in turn, disclosed the adverse news to Eugene Sit, portfolio manager of Investors Variable Payment Fund, Inc., who himself conveyed the information to James Jundt, portfolio manager of IDS New Dimensions Fund, Inc. Both Sit and Jundt are employees of Investors Diversified Services, Inc. (IDS), investment adviser to the two mutual funds. During the morning of Friday, January 9, prior to any public disclosure of the reduced earnings figure, the two mutual funds sold a total of 83,000 shares of Lum's stock on the New York Stock Exchange at a price of approximately $17.50 per share. Later that day, after the Exchange halted trading in Lum's shares, Lum's publicly announced the reduced earnings forecast. Trading did not resume until the following Monday, when the closing price fell to $14.00 per share.

It is important to note at the outset that the plaintiffs in these actions, shareholders of Lum's, do not claim to have suffered any damages themselves. Rather, these derivative suits are brought "on behalf of and for the benefit of Lum's." They seek to recover for Lum's treasury the windfall profit garnered by the IDS mutual funds, and assert that all defendants are jointly and severally liable for this amount. Thus, the proper method of analysis is not to focus on the unfairness of the mutual funds' profit at the expense of their purchasers—who have their own recourse for any wrongdoing—but on the strands of duty running to the corporation from the various individuals involved. The crux of the majority's holding is that the institutional defendants—Lehman Brothers, IDS, and the two mutual funds—and their employees—Simon, Sit, and

Jundt—are within the sweep of fiduciary principles announced in *Diamond* v. *Oreamuno,* 24 N.Y.2d 494, 301 N.Y.S.2d 78 (1969). But a careful examination of that case and the principles underlying it demonstrate that *Diamond* is wholly inapposite to this case.

In *Diamond,* the New York Court of Appeals dealt with a derivative action brought by a shareholder of Management Assistance, Inc. (MAI) against Oreamuno, chairman of the board of directors of the corporation, and Gonzalez, its president. The complaint charged that by virtue of their corporate positions, these officers knew that a supplier's price increase had caused MAI's earnings to decrease by more than 75% during a one month period. According to the allegations, the two officers sold over 50,000 MAI shares at a price of $28 per share prior to public disclosure of the adverse earnings figures, after which the price per share plummeted to $11. In reviewing the Appellate Division's refusal to order dismissal of the complaint against Oreamuno and Gonzalez, Chief Judge Fuld stated at the outset that "the question presented—one of first impression in this court—is whether *officers and directors* may be held accountable to their corporation for gains realized by them from transactions in the company's stock as a result of their use of material inside information," 24 N.Y.2d at 496, 301 N.Y.S.2d at 79 (emphasis added). A careful reading of the *Diamond* opinion reveals that Oreamuno's and Gonzalez's liability in a stockholders' derivative action was grounded solely in their having breached a fiduciary duty owed by them to MAI as corporate officials.

The inapplicability of these principles to any of the appellees[2] is readily apparent. The complaints here are

[2] As noted in the majority opinion, the only defendants remaining on appeal are Lehman Brothers, IDS, the two mutual funds, and Simon. The district court dismissed the actions against Chasen for lack of personal jurisdiction, a holding not challenged on appeal. Accordingly, this court need not comment on the nature and extent of Chasen's liability to Lum's because of his conduct.

barren of any allegation that the appellees—or Sit or Jundt —occupied any position, such as officer, director, employee, or agent, which would create fiduciary obligations to Lum's. *Compare Brophy* v. *Cities Service Co.*, 31 Del. Ch. 241, 70 A.2d 5 (1949); *Quinn* v. *Phipps*, 93 Fla. 805, 113 So. 419 (1927). Liability in *Diamond* was predicated entirely on such a relationship, and in its absence, the *Diamond* rationale for liability ceases to exist.

In an effort to bridge this fatal gap, the majority, without any basis in law or fact, reasons that the appellees were involved in a "joint" or "common enterprise" with Chasen, president of Lum's, "to misuse confidential corporate information for their own enrichment." By use of this interesting, but nevertheless fictional, theory, they seek to foist upon the appellees liability to Lum's for Chasen's improper behavior. But the facts alleged in the complaints are a far cry from the "conscious parallelism" cases, drawn from the antitrust field, cited as authority in the majority opinion; the facts simply do not comport with the concept of a joint enterprise, a term which implies the existence of a prior plan to carry out a mutually beneficial project. The complaints, read in the most favorable light to the plaintiffs, disclose nothing more than a seemingly unsolicited and haphazard revelation of certain information which was useful in making investment decisions. There are ample remedies under the federal securities laws to punish this conduct. But, I am unable to understand on what basis the majority transforms the appellees' spontaneous conduct into a nefarious, prearranged, and ongoing scheme so that "joint" or "common enterprise" principles can make them liable as fiduciaries of a corporation with which they have no relationship.

A primary authority upon which the majority relies, § 312 of the American Law Institute's Restatement of

Agency 2d, exposes the inappropriateness of holding the appellees liable to Lum's for their conduct. Section 312 provides that "A person who, without being privileged to do so, intentionally causes or assists an agent to violate a duty to his principal is subject to liability to the principal." Although Comment *c* to this section speaks generally of receipt of confidential information by a third person from a principal's agent, the central element of liability is the third party's active and intentional aiding in the agent's violation of a duty owed to his principal. In this case, Chasen's duty to Lum's was to not disclose confidential corporate information. Yet there is not a word in the complaint charging that the appellees actively solicited the disclosure or that they had concocted a prearranged scheme with Chasen.[3] We are dealing here with an isolated transaction.

In the absence of any coherent legal theory, I cannot join my brothers in approving the use of the shareholders' derivative action device merely because, as my brothers candidly admit, to do so possibly may have a deterrent effect on "insider trading." Although developments in federal securities law indicate an expanding scope of liability for tippee traders, *see In re* Investors Management Co., Securities and Exchange Commission Release No. 34-9267 (Jul. 29, 1971) (SEC sanctioning of institutional investors

3. It is of no small significance that in the *Diamond* litigation, the Appellate Division affirmed dismissal of the complaint against other MAI directors—fiduciaries to the corporation—who allegedly "approved, acquiesced in or ratified" Oreamuno's and Gonzalez's transactions. 29 A.D.2d 285, 287 N.Y.S.2d 300 (1968). Despite the majority's effort in a footnote to "distinguish" this disposition, I believe the Appellate Division's action is clearly dispositive of the point before us. If the New York courts would not impose liability upon a director—a fiduciary of the corporation—who took no affirmative steps to cause or assist in a breach of a fiduciary duty by the corporation's president, I fail to see by what logic it can be urged that New York courts would hold liable a non-fiduciary who did not cause or assist in the breach.

who sold a corporation's shares after the corporation's underwriter revealed adverse earnings results to them); *cf. SEC* v. *Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1308 (2d Cir. 1971), *cert. denied*, 404 U.S. 1005 (1972) (affirming district court order, in SEC injunctive suit, requiring a "tippor" to divest an amount equal to his tippees' profits), the impetus for developing this expanded federal law liability—whose exact nature and scope remain in a formative stage— is the need to maintain free and honest securities markets. This need appropriately is given great weight when we consider claims under the federal securities law. But it is inapposite in determining whether, *under state common law*, tippee trading is a breach of a fiduciary duty owed to the corporation whose shares are traded, and if so, whether such a breach is remediable through use of a shareholders' derivative action.

In these actions, where jurisdiction is grounded solely in diversity of citizenship, the parties and the majority agree that our duty is to apply the law of Florida. Yet because there are no pertinent Florida decisions, the majority focuses on a New York decision, *Diamond* v. *Oreamuno*, *supra*. Thus, liability is founded on the conclusion of two federal judges that the Florida Supreme Court, if the instant case was before it, would look to a New York decision and, in addition, would give an unprecedented expansive reading to that case.

Despite the manner in which the majority opinion convolutes the law and the facts in this case, a view that a tippee is cloaked with state law fiduciary obligations to the corporation whose shares he trades is an unknown and untenable legal concept. Neither *Diamond*—itself a significant alteration of the common law principles applicable to

an officer's or director's trading in his corporation's shares[4] —nor the law of agency support such a holding. Nothing in the majority opinion tells us why or on what grounds a New York court would hold a tippee trader liable to the corporation for his profits under common law fiduciary principles, and the court exceeds its authority by substituting its own view of what state law ought to be, for what the state law actually is.

Moreover, since the outcome of this case turns, ultimately, upon Florida law, I fail to comprehend why my brothers refuse to utilize Florida's certified question statute, Fla. Stat. Ann. §25.031.[5] This enlightened law provides for certification to the Florida Supreme Court by a federal appellate court of an unresolved question of Florida law which is determinative of a case before it and on which there are no clear, controlling Florida Supreme Court precedents. The statute states that the court, by

4. *See* Note, 1970 Wis. L. Rev. 576, 577. Although not dispositive, this fact augurs against assuming the state courts could make the broad holding so readily attributed to them by the majority.

5. The supreme court of this state may, by rule of court provide that, when it shall appear to the supreme court of the United States, to any circuit court of appeals of the United States, or to the court of appeals of the District of Columbia, that there are involved in any proceeding before it questions or propositions of the laws of this state, which are determinative of the said cause, and there are no clear controlling precedents in the decisions of the supreme court of this state, such federal appellate court may certify such questions or propositions of the laws of this state to the supreme court of this state for instructions concerning such questions or propositions of state law, which certificate the supreme court of this state, by written opinion, may answer.

This statutory authority has been implemented by Appellate Rule 4.61.

written opinion, then may answer the certified question. *See Aldrich* v. *Aldrich*, 375 U.S. 249 (1963); *Green* v. *American Tobacco Co.*, 304 F. 2d 170 (5th Cir. 1962). The uncertainty inherent in the majority's speculation over what the Florida courts would decide if faced with this novel question of tippee liability under state common law fiduciary principles in a stockholders' derivative action would be dispelled authoritatively and finally.

Accordingly, I respectfully dissent.

UNITED STATES COURT OF APPEALS
FOR THE
SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the tenth day of May, one thousand nine hundred and seventy-three.

Present—Hon. STERRY R. WATERMAN
Hon. J. JOSEPH SMITH
Hon. IRVING R. KAUFMAN, Circuit Judges.

72-1373—72-1375

JACOB SCHEIN and MARVIN H. SCHEIN,
Plaintiffs-Appellants,

v.

MELVIN CHASEN; INVESTORS DIVERSIFIED SERVICES, INC.; LEHMAN BROTHERS; INVESTORS VARIABLE PAYMENT FUND, INC.; BENJAMIN SIMON; IDS; NEW DIMENSIONS FUND, INC.; EUGENE C. SIT; JAMES R. JUNDT and LUM'S, INC.,
Defendants-Appellees.

ANTONE F. GREGORIO, individually and as representative of all persons similarly situated as a class under Rule 23 FRCP,
Plaintiff-Appellant,

v.

LUM'S INC., MELVIN CHASEN, LEHMAN BROTHERS, BENJAMIN SIMON, INVESTORS DIVERSIFIED SERVICES, INC., EUGENE C. SIT and JAMES R. JUNDT,
Defendants-Appellees.

Appeal from the United States District Court for the Southern district of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is reversed and that the action be and it hereby is remanded to said District Court for further precedings consistent with the opinion of this court with costs to be taxed against the appellees.

A. Daniel Fusaro
Clerk

UNITED STATES COURT OF APPEALS

Second Circuit

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House in the City of New York, on the eighth day of June, one thousand nine hundred and seventy-three

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Jacob Schein and Marvin H. Schein,
Plaintiffs-Appellants,

v.

Melvin Chasen; Investors Diversified Services, Inc.; Lehman Brothers; Investors Variable Payment Fund, Inc.; Benjamin Simon; IDS; New Dimensions Fund, Inc.; Eugene S. Sit; James R. Jundt and Lum's, Inc.,
Defendants-Appellees.

Antone F. Gregorio, individually and as representative of all persons similarly situated as a class under Rule 23 FRCP,
Plaintiff-Appellant,

v.

Lum's Inc., Melvin Chasen; Lehman Brothers; Benjamin Simon; Investors Diversified Services, Inc.; Eugene S. Sit and James R. Jundt,
Defendants-Appellees.

A petition for rehearing in banc having been filed herein by counsel for the Defendant-Appellee Benjamin Simon and no active circuit judge having requested that a vote be taken on said suggestion

Upon consideration thereof, it is

Ordered that said petition be and it hereby is denied.

A. Daniel Fusaro
Clerk

UNITED STATES COURT OF APPEALS

Second Circuit

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the eighth day of June, one thousand nine hundred and seventy-three

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Jacob Schein and Marvin H. Schein,
Plaintiffs-Appellants,

v.

Melvin Chasen; Investors Diversified Services, Inc.; Lehman Brothers; Investors Variable Payment Fund, Inc.; Benjamin Simon; IDS; New Dimensions Fund, Inc.; Eugene S. Sit; James R. Jundt and Lum's, Inc.,
Defendants-Appellees.

Antone F. Gregorio, individually and as representative of all persons similarly situated as a class under Rule 23 FRCP,
Plaintiff-Appellant,

v.

Lum's Inc., Melvin Chasen, Lehman Brothers, Benjamin Simon, Investors Diversified Services, Inc., Eugene S. Sit and James R. Jundt,
Defendants-Appellees,

A petition for rehearing in banc having been filed herein by counsel for the appellee Lehman Brothers and no active circuit judge having requested that a vote be taken on said suggestion

Upon consideration thereof, it is

Ordered that said petition be and it hereby is denied.

A. Daniel Fusaro
Clerk

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

Docket Nos. 72-1373, 72-1375

At a stated term of the United States Court of Appeals in and for the Second Circuit held at the United States Court House, in the City of New York on the eighteenth day of June, one thousand nine hundred and seventy-three.

Present: Hon. IRVING R. KAUFMAN
Hon. S. R. WATERMAN
Hon. J. JOSEPH SMITH, Circuit Judges.

JACOB SCHEIN and MARVIN H. SCHEIN,
Plaintiffs-Appellants,

v.

MELVIN CHASEN; INVESTORS DIVERSIFIED SERVICES, INC.; LEHMAN BROTHERS; INVESTORS VARIABLE PAYMENT FUND, INC.; BENJAMIN SIMON; IDS; NEW DIMENSIONS FUND, INC.; EUGENE S. SIT; JAMES R. JUNDT and LUM'S, INC.,
Defendants-Appellees.

ANTONE F. GREGORIO, individually and as representative of all persons similarly situated as a class under Rule 23 FRCP,
Plaintiff-Appellant,

v.

LUM'S, INC.; MELVIN CHASEN, LEHMAN BROTHERS; BENJAMIN SIMON; INVESTORS DIVERSIFIED SERVICES, INC.; EUGENE S. SIT; and JAMES R. JUNDT,
Defendants-Appellees.

A petition for a rehearing having been filed herein for counsel for the appellees Investors Diversified Services, Inc., Investors Variable Payment Fund, Inc., and IDS New Dimensions Fund, Inc.,

Upon consideration thereof, it is

Ordered that said petition be and it hereby is denied.

A. DANIEL FUSARO

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

Docket Nos. 72-1373, 72-1375

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the eighteenth day of June, one thousand nine hundred and seventy-three,

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JACOB SCHEIN and MARVIN H. SCHEIN,
Plaintiffs-Appellants,

v.

MELVIN CHASEN; INVESTORS DIVERSIFIED SERVICES, INC.; LEHMAN BROTHERS; INVESTORS VARIABLE PAYMENT FUND, INC.; BENJAMIN SIMON; IDS; NEW DIMENSIONS FUND, INC.; EUGENE S. SIT; JAMES R. JUNDT and LUM'S, INC.,
Defendants-Appellees.

ANTONE F. GREGORIO, individually and as representative of all persons similarly situated as a class under Rule 23 FRCP,
Plaintiff-Appellant,

v.

LUM'S, INC.; MELVIN CHASEN, LEHMAN BROTHERS; BENJAMIN SIMON; INVESTORS DIVERSIFIED SERVICES, INC.; EUGENE S. SIT and JAMES R. JUNDT,
Defendants-Appellees.

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for the appellees Investors Diversified Services, Inc., Investors Variable Payment Fund, Inc., and IDS New Dimensions Fund, Inc., and no active circuit judge having requested that a vote be taken on said suggestion.

Upon consideration thereof, it is

Ordered that said petition be and it hereby is denied.

A. DANIEL FUSARO
Clerk

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IN THE

Supreme Court of the United States

October Term, 1973

No. 73-440

BENJAMIN SIMON,

Petitioner, et al.,

v.

JACOB SCHEIN and MARVIN H. SCHEIN,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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September 6, 1973

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IN THE

Supreme Court of the United States

October Term, 1973

No. .....

BENJAMIN SIMON,

Petitioner, et al.,

v.

JACOB SCHEIN and MARVIN H. SCHEIN,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

The Petitioner, Benjamin Simon, respectfully prays that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit entered in this proceeding on May 10, 1973.

Opinions Below

The opinion of the Court of Appeals, not yet reported, appears as Appendix A hereto. An opinion rendered by the District Court for the Southern District of New York on December 16, 1971, reported *sub nom. Gildenhorn* v. *Lum's, Inc.*, 335 F. Supp. 329 (S.D.N.Y. 1971), appears as Appendix B hereto.

Jurisdiction

The judgment of the Court of Appeals for the Second Circuit was entered in this case and the companion case of *Gregorio* v. *Lum's, Inc., et al.*, on May 10, 1973. A timely petition for rehearing *en banc* on behalf of defendant Simon was denied on June 8, 1973, and this petition for certiorari is filed within 90 days of that date. This Court's jurisdiction is invoked under 28 U.S.C. §1254(1).

The original defendants in this action and in the companion *Gregorio* suit, in addition to the derivative corporate defendant Lum's, Inc., were Lum's chief executive officer, Melvin Chasen; the brokerage firm of Lehman Brothers* and (in the *Schein* action only) one of its registered representatives, the petitioner Benjamin Simon; Investors Diversified Services* ("IDS"), two IDS fund managers, Eugene Sit and James R. Jundt and (in the *Schein* action only) two IDS mutual funds, Investors Variable Payment Fund,* Inc. and IDS New Dimensions Fund, Inc.* Dismissal of both actions was ordered in the District Court as to the defendants Chasen, Sit and Jundt for lack of personal jurisdiction and no appeal was taken therefrom.

Questions Presented

1. Whether the Court of Appeals for the Second Circuit departed from its obligation to discover and apply Florida law in this diversity case by holding, without precedent in the law of Florida or any other state, that a corporation has a common law right of action against third persons not its fiduciaries for profits made by their "tip-

* Parties also filing petitions for certiorari.

pees" in trading the corporation's stock on the basis of material, non-public information?

2. Whether a federal court, confronted with a novel and important question of state law for which it can find no pertinent state authority, is not required to make use of the procedure, where the state has made one available, for certification of such questions to her highest court, rather than decide the case on the basis of its own view of what the "common law" should be?

Statutory Provisions Involved

Rules of Decision Act, 28 U.S.C. §1652:

State laws as rules of decision

"The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States in cases where they apply."

Florida Statutes Annotated, §25.031:

Supreme court authorized to receive and answer certificates as to state law from federal appellate courts.

"The supreme court of this state may, by rule of court, provide that, when it shall appear to the supreme court of the United States, to any circuit court of appeals of the United States, or to the court of appeals of the District of Columbia, that there are involved in any proceeding before it questions or propositions of the laws of this state, which are determinative of the said cause, and there are no clear controlling precedents in the decisions of the supreme court of this state, such

federal appellate court may certify such questions or propositions of the laws of this state to the supreme court of this state for instructions concerning such questions or propositions of state law, which certificate the supreme court of this state, by written opinion, may answer."

Statement of the Case

This shareholders derivative action was brought in the United States District Court for the Southern District of New York on behalf of Lum's, Inc., a Florida corporation engaged in the fast-food franchising business. The sole basis for federal jurisdiction is diversity of citizenship. It was conceded by all below that the governing law is that of the state of Florida, where the derivative defendant Lum's is incorporated.

The complaint alleged, in substance, that the defendant Melvin Chasen, as Lum's chief executive officer, learned that projections of the company's earnings were being revised substantially downward; that Chasen disclosed this information to the petitioner Benjamin Simon, a registered representative employed by Lehman Brothers, and that Simon conveyed the information to his clients, the portfolio managers Eugene Sit and James Jundt of IDS. On the next morning, the IDS funds managed by Sit and Jundt sold 63,000 shares of Lum's common stock at a price of approximately $17.50 per share. Later that day trading in Lum's was halted pending a company announcement with respect to the downward revision of its earnings projections. When trading resumed the next Monday, the opening price was down some three and one-half points

from the price the IDS funds had received the previous Friday.

The facts alleged in the instant complaint are the familiar stuff of actions brought under §10(b) of the Securities Exchange Act of 1934* and are indeed taken virtually verbatim from the complaints in pending actions arising from the same incident brought under Rule 10b-5** by the SEC and by purchasers of Lum's stock as a class.† The instant suit, however, alleges no violation of federal securities law. It asserts, instead, that Chasen of Lum's breached his fiduciary duty to that corporation by disclosing confidential information concerning its affairs to Simon, and that Simon, Lehman Brothers and the IDS defendants "aided and abetted" Chasen in his breach of duty by "[using] the aforesaid confidential information for their own personal profit." It was, however, established by uncontradicted affidavits below, and the District Court so found (App. 31a), that the IDS sale in question was not executed through Lehman Brothers and that neither Simon nor Lehman Brothers received any commission or other form of profit on the transaction.

Judge Tyler in the District Court for the Southern District of New York granted motions to dismiss pursuant to Rule 12 (b)(6) of the Federal Rules of Civil Procedure on behalf of Simon, Lehman Brothers, IDS and the IDS funds for failure to state a claim on which relief could be granted. Respondents' appeals from Judge Tyler's order of dismissal were argued in October, 1972 before a panel of

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* 15 U.S.C. §78j.

** 32 C.F.R. §240.10b-5 (1973).

† *SEC* v. *Lum's, Inc., et al.*, 70 Civ. 1734 (S.D.N.Y.); *Sanders* v. *Lum's, Inc., et al.*, 71 Civ. 5331 (S.D.N.Y.).

the Court of Appeals for the Second Circuit consisting of Judges Waterman, Smith and Kaufman. The Court of Appeals in an opinion by Judge Waterman, reversed the District Court and held that the complaints did state a claim on which relief could be granted. Judge Kaufman dissented.

Reasons for Granting the Writ

By its decision in this case, the Second Circuit Court of Appeals has enacted an important new piece of securities legislation. It is now the law in the Second Circuit that a person with no fiduciary or other relationship to a corporation, who trades its stock on the basis of material non-public information, becomes by that act a "fiduciary" accountable to the corporation for his "breach of duty." The right of the corporation under this new enactment is different than that afforded it by Congress to reach "insider short-swing profits" under Section 16(b) of the Securities Exchange Act of 1934; moreover, the corporation can recover, unlike a public investor suing under §10 (b), even though it sustains no damage by reason of the alleged wrongdoing. Nor is the benefit of this sweeping new legislation confined to Florida corporations, for the Court of Appeals, although ostensibly deciding a question of Florida law, in fact based its result on the "strong desirability of tightening the law of insider trading" (App. 11a), which concern it then assumed would impel a Florida court—and perforce the courts of any other of the other 49 states which have never imposed such liability—to punish for breach of fiduciary duty persons who owe no such duty under the common law.

This case should have been decided under Florida common law. It was not: Judge Kaufman pointed out in his

forceful dissent below that the "* * * view that a tippee is cloaked with the state law fiduciary obligations to the corporation in whose stock he trades is an unknown and untenable legal concept" (App. 22a-23a). Having established that Florida's courts—or indeed the courts of any other state—have never held non-profiting non-fiduciaries such as Simon and Lehman Brothers accountable to a corporation for tippee trading in its stock, the Court of Appeals should have concluded, as did the District Court, that the complaint in this action failed to state a claim upon which relief could be granted under applicable state law. Alternatively, the Court of Appeals might have resorted to the procedure, adopted by the Florida legislature "with rare foresight", *Clay* v. *Sun Insurance Office,* 363 U.S. 207, 212 (1960), which authorizes the Florida Supreme Court to answer unresolved questions of Florida law certified to it by a federal court. Instead, the majority below abandoned Florida law and, turning for "persuasive authority" (App. 6a) to the novel New York Court of Appeals decision in *Diamond* v. *Oreamuno,* 24 N.Y.2d 494, 301 N.Y.2d 78 (1969), gave that decision an unprecedented, expansive reading, based on federal securities law policy considerations, which has no foundation in the common law of Florida or any other state.

I

The Court of Appeals decision in this case is an abuse of federal jurisdiction.

The Rules of Decision Act and *Erie R. Co.* v. *Tompkins*, 304 U.S. 64 (1938), require that state law be applied in the federal courts to determine matters not governed by the Federal Constitution or by Acts of Congress. As Mr. Justice Brandeis said in *Erie*:

> "There is no federal general common law. Congress has no power to declare substantive rules of common law applicable in a state whether they be local in their nature or 'general', be they commercial law or part of the law of torts." 304 U.S. at 78.

This Court's supervisory responsibility for the proper functioning of the federal courts extends to insuring that the federal-state boundary drawn by *Erie* is properly observed. Its intervention is required where, as here, a federal court has departed from its obligation to discover and apply state law to make an important pronouncement of that "federal general common law" which *Erie* forbade.

In the instant case the Court of Appeals found, correctly, that no Florida court has faced "the precise issues" presented here (App. 7a). Instead of searching, however, as a Florida court would have done, for Florida decisions defining the nature of fiduciary obligation in analogous situations, the Second Circuit Court of Appeals turned to the unique New York Court of Appeals decision in *Diamond* v. *Oreamuno, supra,* which held for the first time

in any jurisdiction that a corporation may recover the profits of its officers and directors who abuse their office by trading on inside information even though the corporation sustains no damage by such trading. To justify its reliance on *Diamond*, the Court of Appeals cited two federal district court cases* which contain language to the effect that a federal court, presented with a question not passed upon by the courts of the state concerned, may reasonably assume that its courts would adopt the rule followed in a majority of jurisdictions. This Court has never given its approval to such a method of finding state law, but even if it were valid its proper application to this case would have resulted in dismissal of the complaint because *Diamond* v. *Oreamuno*, *supra*, being the law of only one state, is a "minority" and not a "majority" rule.

Having made one imaginative leap to assume that a Florida court would have decided this case under *Diamond*, the Court of Appeals took a second jump to find that a Florida court would extend *Diamond* to reach the third-party defendants in this case because "*Diamond*, the law of the jurisdiction in which the New York Stock Exchange is seated, has the prophylactic effect of providing a disincentive to insider trading" (App. 10a). As both Judge Kaufman and the able district judge below concluded, however, a reading of the *Diamond* case does not support its extension to reach alleged tippees such as petitioner Simon who were not officers or directors of the corporation involved.

Diamond v. *Oreamuno* was a derivative suit against the Chairman and President of a company alleging that they had learned, by virtue of their corporate positions, of a

* *Baxter* v. *Lancer Industries, Inc.*, 213 F. Supp. 92 (E.D.N.Y.), *appeal denied*, 324 F.2d 286 (2d Cir. 1963) and *Locke Mfg. Companies* v. *United States*, 237 F. Supp. 80 (D. Conn. 1964).

decrease in the company's earnings and had sold stock of the company before news of the decrease became public. At the outset of the Court of Appeals' opinion, Chief Judge Fuld stated that "the question presented—one of first impression in this Court—is whether *officers and directors* may be accountable to their corporation for gains realized by them from transactions in the company's stock as a result of their use of material inside information." 24 N.Y.2d at 496, 301 N.Y.S.2d at 79 (emphasis added). In holding that such liability might be imposed, the Court of Appeals reasoned that confidential information about a company is its property and cannot be appropriated by those who owe it a fiduciary duty, regardless of whether the corporation is damaged by the fiduciary's breach:

> "In our opinion, there can be no justification for permitting officers and directors, such as the defendants, to retain for themselves profits which, it is alleged, they derived solely from exploiting information granted by virtue of their inside position as corporate officials." 24 N.Y.2d at 498-99, 301 N.Y.S.2d at 81.

The holding in *Diamond* was based upon traditional equitable principles relating to duties owed by a fiduciary and on equity's distaste for allowing a fiduciary to profit from his office. Since the liability imposed by *Diamond* arises from the breach of a fiduciary duty, its holding has no application to a securities salesman such as the petitioner who owed no duty, fiduciary or otherwise, to Lum's. When no fiduciary duty exists, in short, it is manifest that there can be no cause of action for breach of such a duty.*

* The lone Florida decision cited in the text of the majority opinion below (App. 11a), *Quinn* v. *Phipps*, 93 Fla. 805, 113 So. 419 (1927), merely confirms this principle. The issue in *Quinn* was whether a real estate broker who negotiated a purchase of property for himself could be held liable to the client on whose behalf he had agreed to act, and the court's conclusion that a fiduciary relationship existed between the parties was, of course, the basis on which liability was imposed.

As this Court said in *West* v. *American Telephone & Telegraph Co.*, 311 U.S. 223 (1940), it is the duty of a federal court in a case governed by state law

> "* * * in every case to ascertain from all available data what the state law is and apply it rather than to prescribe a different rule, however superior it may appear from the viewpoint of 'general law' * * *." 311 U.S. at 237.

The Second Circuit Court of Appeals departed from its duty in this case by reasoning, not from common-law principles governing the duty owed by a fiduciary to his cestui que trust, but rather from its frequently expressed view of the "* * * desirability of tightening the law of insider trading" (App. 11a). Nor, indeed, is a right in the issuing corporation to recover the tippee's profits under state law consistent with the right of damaged investors to recover those profits in a suit under the federal securities laws. The potential for federal-state disharmony created by this decision is evident from the casual suggestion (App. 14a) of the majority below by way of a footnote reference to the remand opinion in *SEC* v. *Texas Gulf Sulphur*,* that the (federal?) court could require the corporation's recovery to be held for the benefit of injured stockholders. By what authority could a state court (or a federal court in a diversity case) so limit the corporation's common law "right"? The decision in this case is no less offensive to federal law than to the state law on which it should have been, but was not, founded.

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* 312 F. Supp. 77, 93 (S.D.N.Y. 1970), *aff'd in part, rev'd in part*, 446 F.2d 1301 (2d Cir.), *cert. denied*, 404 U.S. 1005, *reh. denied*, 404 U.S. 1064 (1971).

II

The Court of Appeals should have turned to Florida's Supreme Court for an authoritative answer to the question presented by this case.

The Second Circuit Court of Appeals decision in this case exemplifies the difficulties which federal courts sometimes encounter, and the temptations to which they may succumb, when confronted with an important question of state law for which there is no apparent state precedent. The majority below professed itself unable to decide this case by reference to Florida authority—but the very absence of such authority renders purely speculative the majority's conclusion that a Florida court would have adopted its reasoning. The Second Circuit's result here cannot be defended, as was its decision in *Propper* v. *Clark*, 337 U.S. 472, 486-87 (1949), as the "reasonable conclusion" of a federal court skilled in the law of the particular state. The Second Circuit, whatever its expertise in interpreting New York law, can lay claim to none in interpreting the law of Florida, and there is no reason to suppose that the tortuous process by which it reached its conclusion in this case represents the law of Florida. Here, moreover, by contrast with *Propper*, the federal judges who heard this case were evenly divided as to whether the complaint stated a claim for relief under New York law as enunciated in *Diamond*, Judge Tyler in the District Court and Judge Kaufman in the Court of Appeals being strongly of the view that it did not.

Both the necessity for speculation and the tendency exhibited here of federal judges to write their own laws

when state law as they perceive it is a blank, are unhealthy to sound federal-state relations. Both should be minimized as far as possible. Here they could have been eliminated altogether, by resort to Florida's well-established procedure, adopted following this Court's decision in *Meredith* v. *Winter Haven,* 320 U.S. (1943), for the certification to its Supreme Court of unresolved questions of Florida law arising in the federal courts.*

Use of the Florida certification procedure was required by this Court in *Clay* v. *Sun Insurance Office,* 363 U.S. 207 (1960), where a lower federal court, apparently deeming the state law issue more difficult than the constitutional one, held a Florida statute unconstitutional without deciding whether the statute would apply to nullify a provision of the contract in question. This Court, seeking to avoid the unnecessary decision of the constitutional issue, remanded the case for a determination of whether the Florida statute applied as a matter of state law:

> "The Florida Legislature, with rare foresight, has dealt with the problem of authoritatively determining unresolved state law involved in federal litigation by a statute which permits a federal court to certify such a doubtful question of state law to the Supreme Court of Florida for its decision. Fla. Stat. Ann., 1957, §25.031. Even without such a facilitating statute we have frequently deemed it appropriate, where a federal constitutional question might be mooted thereby, to secure an authoritative state court's determination of an unresolved question of its local law." 363 U.S. at 212.

* The current version of this statute, originally adopted in 1945, is reproduced *supra* at page 3.

Use of Florida's certification procedure was subsequently directed by this Court in *Dresner* v. *City of Tallahassee*, 375 U.S. 136 (1963) and in *Aldrich* v. *Aldrich*, 375 U.S. 249 (1963). The Fifth Circuit has also uniformly certified "doubtful questions" of Florida law to the Florida Supreme Court.* In *Martinez* v. *Rodriquez*, 410 F.2d 729 (5th Cir. 1969), the court commended the dispatch with which Florida's Supreme Court responded to such inquiries and stated:

> "We would be remiss if we did not once again seize the opportunity to extol the virtues of the Florida certification procedure. For example, while this Court following the footsteps of the stalwarts below might have reached the same conclusion as that of the Florida Court with respect to the issue in this case, our decision would have had no assurance of predictable correctness. No matter how many Federal Judges, trial, appellate, three-Judge panel, or the full panoply of the court en banc, any decision would have been an *Erie*-guess. Now the guesswork has been eliminated, and we are quickly presented with a definitive explication of Florida law." 410 F.2d at 730.

Florida's enactment of the certification procedure represents the considered policy and preference of her Legislature to avoid precisely what happened in this case—the pronouncement by a distant federal court of an unprecedented expansion of a unique New York decision as

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* *See, e.g., Gordon* v. *John Deere Co.*, 451 F.2d 234 (5th Cir. 1971); *Allen* v. *Estate of Carman*, 446 F.2d 1276 (5th Cir. 1971); *A. R. Moyer, Inc.* v. *Graham*, 443 F.2d 434 (5th Cir. 1971); *Boyd* v. *Bowman*, 443 F.2d 848 (5th Cir. 1971); *Trail Builders Supply Co.* v. *Reagan*, 409 F.2d 1059 (5th Cir. 1969); *Gaston* v. *Pittman*, 405 F.2d 869 (5th Cir. 1969); *Life Insurance Co. of Va.* v. *Schifflet*, 370 F.2d 555 (5th Cir. 1967); and *Hopkins* v. *Lockheed Aircraft Corp.*, 358 F.2d 347 (5th Cir. 1966).

"Florida law". As Florida dislikes such speculation and has provided a statutory means for avoiding it, her preference should be respected, not only in the Fifth Circuit but throughout the federal court system.

This Court required resort to Florida's certification procedure in *Clay, supra*, for the purpose of avoidng an unnecessary constitutional decision rather than for the purpose proposed here, which is to avoid unnecessary guesswork by the federal courts, as well as impermissible crossings of the *Erie* line, in passing upon important questions of state law. Although this Court has not passed upon use of the certification procedure for this latter purpose, it has nonetheless demonstrated its willingness to require a federal court to stay its hand in the interests of comity and harmonious federal-state relations even where no federal constitutional issue was presented. *Kaiser Steel Corp.* v. *W. S. Ranch Co.*, 391 U.S. 593 (1968), was a diversity suit involving the interpretation of a New Mexico statute concerning water rights and its validity under the state constitution. A declaratory judgment action to determine the critical state issues was pending in the state courts. This Court, holding that the federal appellate court had erred in refusing to stay the federal suit pending the state court's determination, observed that the state law issues involved were of vital concern, were truly novel and in all likelihood would soon be resolved by the state court.

A stay of federal court proceedings pending a forthcoming state determination such as was ordered in *Kaiser* is similar to use of a state's certification procedure in the important respect that, in both instances, the desirable

objective of obtaining an authoritative resolution of the state law question is achieved without the sacrifice of the federal court's jurisdiction. In its 1943 decision in *Meredith* v. *Winter Haven, supra,* this Court held that, except in special circumstances where abstention might be necessary to avoid a constitutional issue, a federal court was required to decide state law questions presented to it, no matter how obscure or difficult they might be, in order not to defeat federal diversity jurisdiction. In *Meredith* and many simliar cases, the result of abstention would have been the inability of the federal court to entertain the action and, consequently, its dismissal. To require federal courts to make use, in appropriate cases, of the certification procedure of Florida or other states would not offend the rationale of *Meredith* because certification would not divest the federal court of its jurisdiction or otherwise deprive it of its authority to hear and decide the case.

It is important that novel questions of state law arising in the federal courts be decided under the law of the state concerned and not, as here, on the basis of unfounded speculation. The very limitations which this Court has imposed on its review of federal court determinations of state law issues make it all the more important that the federal court's decision, insofar as possible, represent an authoritative statement of state law. Difficulties arise, of course, in those infrequent instances where applicable state law furnishes the federal court with no basis whatsoever for arriving at a reasonable "forecast" of how the state's highest court would decide the question. It is submitted, however, on behalf of petitioner Simon, that where a state such as Florida has made available to the federal courts

a means for obtaining an authoritative answer to such a question, the federal court should be required to take advantage of that procedure rather than setting sail, as the Second Circuit did in this case, under its own stars.

Conclusion

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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LAURA BANFIELD
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WHITE & CASE
Of Counsel

September 6, 1973

APPENDICES

Appendix A

Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 81 and 82—September Term, 1972

(Argued October 17, 1972 Decided May 10, 1973)

Docket Nos. 72-1373, 72-1375

JACOB SCHEIN and MARVIN H. SCHEIN,
Plaintiffs-Appellants,

v.

MELVIN CHASEN, INVESTORS DIVERSIFIED SERVICES, INC., LEHMAN BROTHERS, INVESTORS VARIABLE PAYMENT FUND, INC., BENJAMIN SIMON, IDS NEW DIMENSIONS FUND, INC., EUGENE S. SIT, JAMES R. JUNDT, and LUM'S, INC.,
Defendants-Appellees.

ANTONE F. GREGORIO, individually and as representative of all persons similarly situated as a class under Rule 23, F.R.C.P.,
Plaintiff-Appellant,

v.

LUM'S, INC., MELVIN CHASEN, LEHMAN BROTHERS, BENJAMIN SIMON, INVESTORS DIVERSIFIED SERVICES, INC., EUGENE S. SIT, and JAMES R. JUNDT,
Defendants-Appellees.

Before:

WATERMAN, SMITH and KAUFMAN, *Circuit Judges.*

Invoking the diversity jurisdiction of the court, plaintiffs in three cases consolidated below sued derivatively

in United States District Court for the Southern District of New York, Tyler, *J.*, alleging that defendants were jointly and severally liable under state corporation law for the profits realized by the defendants Mutual Funds through their trading on the New York Stock Exchange in derivative defendant's stock on the basis of non-public material inside information. An order granting summary judgment was granted to defendants and in two of the consolidated actions the parties have argued appeals.

Reversed and remanded for further proceedings consistent with this opinion.

WATERMAN, *Circuit Judge*:

Plaintiffs-appellants are stockholders in Lum's, Inc., a Florida corporation primarily engaged in restaurant franchising. Invoking the diversity jurisdiction of the court, they sued derivatively in the Southern District of New York alleging that the defendants were jointly and severally liable to Lum's for actionable wrongs which the defendants had committed against Lum's. The individual defendants were Melvin Chasen, a resident of Florida, president of Lum's, Benjamin Simon, a stockbroker employed in Chicago, Ill. by defendant Lehman Brothers, Eugene S. Sit, portfolio manager of defendant IDS New Dimensions Fund, Inc., a Mutual Fund, and James R. Jundt, manager of defendant Investors Variable Payment Fund, Inc., a Mutual Fund. Each of the four individual defendants moved for dismissal on the ground that they had not been validly served under the New York Long Arm

Statutes (CPLR §§313, 302(a)) and that the court below had no personal jurisdiction of them. Sit's and Jundt's motions were granted prior to the filing of the order appealed from, Chasen's was granted concurrently therewith, and Simon's has apparently not been acted upon.[1] The defendants Lehman Brothers, a partnership engaged in stock brokerage and investment counseling, the three corporations, engaged in managing investment portfolios and in buying and selling the corporate securities of publicly held corporations, Chasen, and Simon, all moved for dismissal on the ground that the complaints failed to state a cause of action under Florida law. Plaintiffs claimed that New York law should govern the rights and liabilities of the parties, and that even if Florida law were the applicable law they should still prevail. Holding that Florida law was the proper state law to apply, Judge Harold R. Tyler, Jr., by written order, *sub nom Gildenhorn* v. *Lum's, Inc.*, opinion reported at 335 F.Supp. 329 (SDNY 1971), granted the motion to dismiss for failure to state a claim upon which relief could be granted.

On this appeal plaintiffs claim only that Judge Tyler erred in dismissing the complains for failure to state a

1. Plaintiffs-appellants have not appealed the order dismissing the actions against Chasen, Sit and Jundt. Simon filed a similar dismissal motion but the trial court did not decide it. Simon was dismissed as a defendant by the court's order dismissing the complaints against all defendants for failure to state a cause of action under 12(b)(6) of the Fed. R. Civ. P. Simon contends on this appeal that irrespective of our action on the lower court's dismissal of the complaints under 12(b)(6), we should dismiss the action against him because he has not been validly served. However, inasmuch as the trial court has not reached this question, we decline to address it on this appeal, and leave its resolution to the trial court upon remand.

cause of action.[2] They do not appeal Judge Tyler's order dismissing Chasen as a defendant or his finding that the substantive law of Florida governs the action.[3] Inasmuch as the court is passing only upon the sufficiency of the complaints, we necessarily accept the allegations of the complaints as true. For reasons which follow, we hold that the complaints do state a cause of action and we reverse the judgment below and remand to the district court for further proceedings there in the light of this holding.

The facts alleged in this case fall within the perimeter of the much-discussed problem of unfair trading in corporate securities. In November of 1969 Chasen, who was president and chief operating officer of Lum's, addressed a seminar of about sixty members of the securities industry with reference to Lum's earnings prospects for its fiscal year ending July 31, 1970. He informed them that Lum's earnings would be approximately $1.00 to $1.10 per share. On January 5, 1970 he learned that this estimate was too optimistic and that, in fact, Lum's earnings would be only approximately $.76 per share. Three days later, prior to announcing the information to the public, Chasen telephoned Simon in Chicago and told Simon that Lum's would not have as profitable a year as had been expected. He specified to Simon that earnings would be approximately $.76 per share rather than the $1.00 per share which he had earlier announced. Simon knew the information was

2. In one of the original actions consolidated below, Gildenhorn v. Lum's, Inc., 335 F.Supp. 329 (SDNY 1971) a notice of appeal was filed by plaintiff but the parties have not progressed the appeal.

3. The parties now agree that the substantive law of the State of Florida governs the action for reasons which are stated in Judge Tyler's opinion reported at 335 F.Supp. 329 (SDNY 1971).

confidential corporate property which Chasen had not given out publicly. Simon immediately telephoned this information to Sit, an employee of defendant Investors Diversified Services, Inc. (IDS),[4] and Sit immediately telephoned it to Jundt, another employee of IDS. Sit and Jundt managed the stock portfolios of defendant mutual funds Investors Variable Payment Fund, Inc. (Investors) and IDS New Dimension Fund, Inc. (Dimensions). Upon receiving the information Sit and Jundt directed the Funds to sell their entire stock holdings in Lum's and, on the morning of January 9, 1970, prior to any public announcement, Investors sold 43,000 shares of Lum's and Dimensions sold 40,000 shares. The sales were executed on the New York Stock Exchange at about 10:30 A.M. at a price of approximately $17.50 per share. At 1:30 P.M. on the same day, the New York Stock Exchange halted further trading in Lum's stock pending a company announcement. At 2:45 P.M. Lum's issued a release which appeared on the Dow Jones News Wire Service and announced that the corporation's projected earnings would be lower than had been anticipated. When trading in Lum's was resumed on Monday, January 12, 1970, volume was heavy and the stock closed at a price of $14.00 per share—$3.50 per share lower than the Funds had realized from the sales of their shares on the previous Friday.

The present defendants in this case are Lehman Brothers, Simon, and the two Mutual Funds. Chasen,

4. Defendant IDS is a Minnesota corporation licensed to do business in the State of New York. IDS is the distributor and investment advisor for a number of large mutual funds including defendants Investors and Dimensions. Sit and Jundt are employed by IDS to manage the stock portfolios of Investors and Dimensions.

Sit, and Jundt have been dismissed as defendants in that they had not been validly served under the New York State Long Arm Statute. Plaintiffs-appellants' theory of recovery is that the participants in this chain of wrongdoing are jointly and severally liable to the corporation under Florida law for misusing corporate information to their own advantage in violation of the duty they owed to Lum's, and that they must account to Lum's for the profits realized by the Mutual Funds. They do not allege in these complaints that defendants have violated any of the federal securities laws,[5] and they concede that the substantive law of Florida governs the rights and liabilities of the parties. They urge, however, that inasmuch as there are no Florida cases directly in point, the Florida court, if it were deciding the case, would look to other jurisdictions and would take a particular and special interest in the decision of *Diamond* v. *Oreamuno,* 29 A.D.2d 285, 287 N.Y.S.2d 300 (1st Dep't 1968), *aff'd* 24 N.Y.2d 494, 301 N.Y.S.2d 78 (1969), a case which plaintiffs contend supports the position they urge on this appeal.

The first question which our court must consider is whether we may look to the New York decision of *Diamond, supra,* as persuasive authority. Ideally, the federal court sitting in a diversity action applies the applicable state law as it has been enunciated by the highest court in the state. *Erie R. Co.* v. *Tompkins,* 304 U.S. 64 (1938); *Haus-*

5. Lum's could apparently not prevail as a plaintiff in a Rule 10b-5 action in that it has not traded in its securities on its own account. See Birnbaum v. Newport Steel Corporation, 193 F.2d 461 (2 Cir. 1952), cert. denied, 343 U.S. 956 (1952). Although there are federal securities law cases pending against defendants in district court, this fact is irrelevant upon this appeal.

man v. *Buckley,* 299 F.2d 696 (2 Cir. 1962), *cert. denied,* 369 U.S. 885 (1962). However, in the absence of a clearly enunciated state rule, the federal court may turn to the law of other jurisdictions for assistance in determining how the state court would most likely decide the case if the state court were presented with the questions being litigated in the federal court. *Baxter* v. *Lancer Industries, Inc.,* 213 F.Supp. 92 (EDNY 1963), *app. denied,* 324 F.2d 286 (2 Cir. 1963); *Locke Manufacturing Companies* v. *United States,* 237 F.Supp. 80 (D. Conn. 1964). Our foray into the state law of Florida satisfies us that the Florida court has never faced the precise issues which are present in this action. Accordingly, it is both proper and practical for this court to turn for guidance to the body of law of other jurisdictions and particularly to that of New York where the resolution of the issues in the *Diamond* case, decided by the New York Court of Appeals, bears on the issues in the base before us. In doing so, our objective is to interpret *Diamond* as the Florida court would probably interpret it and to apply *Diamond,* as so interpreted, to the facts presented here.

Diamond v. *Oreamuno, supra,* was a stockholder's derivative action in which a shareholder of Management Assistance, Inc. (MAI) charged that two of the defendants —Oreamuno, chairman of the board of directors, and Gonzales, its president and a member of the board, had used inside information acquired by them solely by virtue of their positions with MAI in order to reap large personal profits from the sale of MAI shares, and that these profits rightfully belonged to the corporation. Chief Judge Stan-

ley Fuld, writing for a unanimous court, held that the two directors must account to the corporation for their profits for they had breached their duty to the corporation by using a corporate asset for their own personal advantage.

In this case we are asked to decide whether the *Diamond* holding should extend to reach third parties who, though not officers or directors of the injured corporation, are involved with directors in a common enterprise to misuse confidential corporate information for their own enrichment. Although there is no allegation in the complaints that a prior explicit agreement existed between Chasen and the defendants, it is obvious that the sequence of events detailed in the pleadings, if proved, will substantiate the existence of a common enterprise pursuant to which Chasen was to pass material information to Simon, Simon was to pass it to the Mutual Funds, and the Funds were to capitalize on it by selling Lum's stock prior to the time the material information was announced to and was available to the public. Cf. *American Tobacco Co.* v. *United States*, 328 U.S. 781 (1946); *Interstate Circuit, Inc.* v. *United States*, 306 U.S. 208 (1939); *Norfolk Monument Company* v. *Woodlawn Memorial Gardens, Inc.*, 394 U.S. 700 (1969). Although defendants do not deny that they have been involved in a joint enterprise with Chasen to misuse corporate property, they argue that the doctrine of *Diamond* is not applicable here and that they cannot be held liable to Lum's because they are not Lum's fiduciaries and have not breached any duty which they owed to Lum's by cashing in on confidential information for their own advantage. Defendants Simon and Lehman

Brothers make the further argument that it would be "unfair" to hold them responsible for the profits made by the Mutual Funds in that they (Simon and Lehman Brothers) did not profit personally inasmuch as neither of them traded in Lum's stock.

As a court of equity viewing the case as the Florida court would probably view it, we cannot agree that the "stretch" of *Diamond* does not reach the defendants in this case. We find nothing in the language of *Diamond* to suggest that co-venturers of the director who breaches his duty should not be subject to the same liabilities as those of the director himself for the misuse of corporate information.[6] Indeed, the general rule has always been that "one who knowingly participates in or joins in an enterprise whereby a violation of a fiduciary obligation is effected is liable jointly and severally with the recreant fiduciary." *Oil & Gas Ventures—First 1958 Fund Ltd.* v. *Kung*, 250 F.Supp. 744 (1966); see, *e.g.*, *Jackson* v. *Smith*, 254 U.S. 586, 589 (1921); *Sexton* v. *Sword S.S. Line, Inc.*, 118 F.2d 708, 711 (2 Cir. 1941); *Bankers Life and Casualty Co.* v. *Kirtley*, 338 F.2d 1006, 1013 (8 Cir. 1964). If the *Diamond* court had intended to lay down an exception to this well-known general rule it could have done so in its

6. We believe Judge Tyler erred in attaching dispositive significance to the fact that in Diamond, supra, the complaint was dismissed against certain directors who had only "acquiesced" in the wrong. The defendants-appellees here differ from the dismissed Diamond defendants in that the defendants-appellees were actively engaged in furthering the transaction that resulted in the "dumping" of the Lum's stock, rather than just "acquiescing" in it. Furthermore, and even more importantly, Diamond was not a "joint venture" case, and there is no discussion in the Diamond opinion as to why the complaint was dismissed against the "acquiescing" directors.

opinion. Moreover, in the light of the corporate interest which the *Diamond* rule is designed to protect, it is immaterial to the preservation of that interest whether the director trades on his own account in the corporation's stock or whether he passes on the information to outsiders who then trade in the corporation's stock. In either event, so long as the director is involved, the prestige and good will of the corporation may be tarnished by the public revelation that the director has been involved in unethical conduct. *Diamond, supra* at 499; accord, *S.E.C.* v. *Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1308 (2 Cir. 1971), *cert. denied*, 404 U.S. 1005, *reh. denied*, 404 U.S. 1064 (1972). Accordingly, it would be self-defeating to limit the reach of *Diamond* to directors and officers of the injured corporation who have so acted while permitting third-party co-venturers of theirs to escape liability to the corporation.

Diamond, the law of the jurisdiction in which the New York Stock Exchange is seated, has the prophylactic effect of providing a disincentive to insider trading. It is clear that this cleansing effect ought to reach third parties who, through a breach of a fiduciary relationship, become traders advantageously possessed of confidential insider knowledge. To immunize such third parties from liability to the damaged corporation would encourage insider "leaks" to outside friends and would defeat *Diamond's* purpose and effect. And, quite properly, damage for fiduciary breaches are recoverable by recourse to state law. Indeed, though the congressional policy is similar, in some cases where federal private and governmental Rule 10b-5 actions are impractical, "immunized outsiders"

might escape liability altogether except for the availability of this kind of action bottomed upon the well-recognized liability of a fiduciary to those whose trust in the fiduciary has been tragically misplaced. In view of the strong desirability of tightening the law of insider trading, we would be remiss indeed if we interpreted *Diamond* as narrowly as defendants would have us interpret it. Moreover, sitting as a court of equity, we have here an obligation to determine where the equities lie among all the litigants, *Diamond, supra* at 498, and, as between the defendants and Lum's, there can be no doubt that it would be inequitable to permit the defendants to keep the rewards of fraud.[7]

Our view that all the participants in the common enterprise must assume the same risks of liability to the corporation as the offending director is supported by Florida case law dealing with the duty of a fiduciary to his cestui. The Florida courts have held that the duty of a fiduciary not to misuse the property of his cestui extends not only to the "technical fiduciary" but also to others who are placed in a position of trust. *Quinn* v. *Phipps*, 93 Fla. 805, 113 So. 419 (1927). The confidential relationship of a fiduciary as that relationship is spelled out in Florida

7. This principle has been applied in analogous cases involving violations of the federal securities laws. In more than one instance, the corporation whose stock has been illegally traded has been permitted to recover conditionally in a Rule 10b-5 action because it is more equitable for it to recoup the rewards of the fraud than for the insider who profits by misusing corporate information to keep them. See Securities and Exchange Commission v. Texas Gulf Sulphur, 446 F.2d at 1308; S.E.C. v. Golconda Mining Company, 327 F.Supp. 257 (SDNY 1971).

law extends not only to "technical fiduciaries" but also to others who become "fiduciaries" through the acquisition of confidential information which is "owned" by someone else. See *Quinn* v. *Phipps*, supra at 420-421. When the defendants received their "tip" from Chasen, they were automatically clothed with a duty to Lum's not to use the information for their own selfish advantages. Compare *Brophy* v. *Cities Service Co.*, 31 Del. Ch. 241, 70 A.2d 5 (1949); *Ohio Oil Co.* v. *Sharp*, 135 F.2d 303 (10 Cir. 1943). This is firmly grounded in law and the rule is set forth in the American Law Institute's Restatement of Agency 2d §312 (1958): "A person who, without being privileged to do so, intentionally causes or assists an agent to violate a duty to his principal is subject to liability to the principal." And see Comment c to §312:

> A person who, with notice that an agent is thereby violating his duty to his principal, receives confidential information from the agent, may be enjoined from disclosing it and required to hold profits received by its use as a constructive trustee. * * *

Therefore, if plaintiffs can prove their allegations, it would seem that liability of the Mutual Funds to Lum's must necessarily follow. Be that as it may be however, the defendants Lehman Brothers and Simon contend that it would be inequitable to apply the rule to them because they did not personally profit by trading in Lum's stock and they hold no profits as constructive trustees of that corporation. Nevertheless, Lehman Brothers and Simon obviously misused inside information as much as Diversified

and Investors misused it, and therefore we fail to see how equity would be furthered by imposing liability only on the Funds and not on the other participants who supplied the Funds with the inside information. It is well established that the liabilities of persons engaged in a joint enterprise to commit a wrong are both joint and several liabilities and each participant is liable to account for the profits of the other participants. *Marcus* v. *Otis,* 168 F.2d 649 (2 Cir. 1948), *modified,* 169 F.2d 148 (2 Cir. 1948); *Solomon* v. *United States,* 276 F.2d 669 (6 Cir. 1960), *cert. denied,* 364 U.S. 890 (1960), *reh. denied,* 364 U.S. 939 (1961). Accordingly, we hold that it would be proper to hold Lehman Brothers and Simon just as accountable for the profits made by their tippees Diversified and Investors as the tippees themselves.[8]

Defendants also contend that the complaints are presently insufficient because they fail to allege with sufficient particularity the damages Lum's is claimed to have suffered. This contention is without merit. Although the Gregorio complaint fails to allege any damages to Lum's, the Schein complaint contains a general allegation of dam-

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8. In passing we note decisions dealing with violations of the federal securities laws which involve the imposition of liabilty on defendants who have occupied statuses similar to the statuses occupied by defendants in this case. Thus, in Securities and Exchange Commission v. Texas Gulf Sulphur, 446 F.2d at 1308, the same argument raised by Simon and by Lehman Brothers was raised by defendant Darke. This court held that Darke was liable as a tippor for the profits realized by his tippees. Furthermore, "tippee liability," which is analogous to the liability being imposed upon Diversified and Investors, has been established in federal cases involving violations of the securities laws. See Ross v. Licht, 263 F.Supp. 395 (SDNY 1967); In the Matter of Cady, Robers & Co., 40 S.E.C. 907 (1961).

ages, and we find nothing in Florida law to require anything more than a general ad damnum allegation.[9]

Defendants also urge that inasmuch as there are private Rule 10b-5 class actions for damages, *e.g., Sanders* v. *Lum's, Inc., et al,* 70 Civ. 5331 (SDNY) and an administrative suit brought by the Securities and Exchange Commission, *SEC* v. *Lum's et al,* 70 Civ. 5280 (SDNY), pending in federal district court, defendants might be subjected to multiple liability if they are forced to remit to Lum's the profits the Mutual Funds made on their January 9 sales. Since appellees are fully aware of these federal court actions they are well able to protect themselves from multiple liability.[10]

Preventing those who are privy to confidential inside information from using it to their own advantage has found expression in numerous cases in the federal courts dealing with violations of the federal securities laws. See *Securities and Exchange Commission* v. *Texas Gulf Sulphur,* 401 F.2d 833 (2 Cir. 1968), *cert. denied sub nom.*

9. We find it unnecessary to decide whether the defendants could prevail if *neither* complaint alleged damages to Lum's. We point out, however, that Florida law is not clear on the question and Diamond holds specifically that an allegation of damages is not a prerequisite to a recovery. Diamond v. Oreamuno, supra at 499. The case cited by defendants for the proposition that damages must be alleged (Palma v. Zerbey, 189 So.2d 510 (Fla.App. 1966), cert. denied, 200 So.2d 814 (Fla. 1967) is a one paragraph per curiam opinion of a lower Florida court, the Florida District Court of Appeals which, inasmuch as it fails to provide a discussion of the issues, we find to be totally unpersuasive.

10. See, for example, the method employed in Securities and Exchange Commission v. Texas Gulf Sulphur Co., 312 F.Supp. 77, 93 (SDNY 1970), *aff'd in part, rev'd in part,* 446 F.2d 1301 (2 Cir. 1971), cert. denied, 404 U.S. 1005 (1971), reh. denied, 404 U.S. 1064 (1971).

Coats v. *SEC*, 394 U.S. 976 (1969); *List* v. *Fashion Park, Inc.*, 340 F.2d 457 (2 Cir. 1965), *cert. denied*, 382 U.S. 811 (1965); *Wohl* v. *Blair & Co.*, 50 F.R.D. 89 (SDNY 1970); *Ross* v. *Licht*, 263 F.Supp. 395 (SDNY 1967); *Speed* v. *Transamerica Corp.*, 99 F.Supp. 808, 828-829 (D. Del. 1951), *aff'd*, 235 F.2d 369 (3 Cir. 1956).

Accordingly, as to those persons found to be within the jurisdiction of the court, we reverse the order appealed from and remand the case for such further proceedings below as may be consistent with the contents of this opinion.

Appendix A—Dissenting Opinion of the Court of Appeals

KAUFMAN, *Circuit Judge* (dissenting):

In my view, it is no longer debatable that trading on inside information merits universal condemnation.[1] The undesirable nature of "insider trading" is reflected in the prophylactic provisions of Section 16(b) of the Securities Exchange Act of 1934 and the more general antifraud principles of Section 10b of that Act. I fully agree with Judges Waterman and Smith that one with access to material inside information concerning a corporation's affairs who knowingly purchases or sells that corporation's shares before this information has become publicly available takes unfair advantage of unknowledgeable parties to the transaction. Indeed, the factual claims contained in the complaints before us have led to two federal actions—an SEC injunctive action and a private class action under rule 10b-5—now pending in the District Court for the Southern District of New York. But the adage that hard facts make bad law is about to come true here, despite Judge, later Justice, Cardozo's warning that judges are not free agents roaming at will to create law to fit the facts. *See* The Nature of the Judicial Process 141 (1921). In the absence of any viable precedent upon which to base the totally new concept of law espoused by my brothers, it is clear that they announce an extraordinary, expansive, and incorrect reading of New York law solely because of their urge to "provid[e] a disincentive to insider trading." I agree with their objective but I question the means employed.

1. But for a contrary view, *see* H. Manne, Insider Trading and the Stock Market (1966).

The court holds today that a person with no relationship whatsoever—fiduciary or otherwise—to a corporation, who trades its shares on the basis of material inside information becomes, *ipso facto,* a fiduciary of the corporation whose shares he traded and, accordingly, may be required in a *shareholders' derivative action*—not a Section 10(b) or 16(b) action—to pay his profits to the corporation. With all due respect to my brothers, the tortured reasoning to which they are compelled to resort in reaching this conclusion represents a distortion of the law of agency and the law of fiduciary responsibility in which I am unable to join. Accordingly, I dissent.

Stripped of excess verbiage, the complaints in the two consolidated stockholders' derivative actions before us make the following allegations. In January, 1970, Melvin Chasen, president of Lum's, learned that an earnings estimate of between $1.00 and $1.10 per share previously released to the financial community was grossly inaccurate. A more realistic figure was $.76 per share. Chasen revealed this information on January 8, during a telephone conversation, to Benjamin Simon, an employee in Lehman Brothers Chicago office. Simon, in turn, disclosed the adverse news to Eugene Sit, portfolio manager of Investors Variable Payment Fund, Inc., who himself conveyed the information to James Jundt, portfolio manager of IDS New Dimension Fund, Inc. Both Sit and Jundt are employees of Investors Diversified Services, Inc. (IDS), investment adviser to the two mutual funds. During the morning of Friday, January 9, prior to any public disclosure of the reduced earnings figure, the two mutual funds sold a total of 33,000 shares of Lum's stock on the

New York Stoch Exchange at a price of approximately $17.50 per share. Later that day, after the Exchange halted trading in Lum's shares, Lum's publicly announced the reduced earnings forecast. Trading did not resume until the following Monday, when the closing price fell to $14.00 per share.

It is important to note at the outset that the plaintiffs in these actions, shareholders of Lum's, do not claim to have suffered any damages themselves. Rather, these derivative suits are brought "on behalf of and for the benefit of Lum's." They seek to recover for Lum's treasury the windfall profit garnered by the IDS mutual funds, and assert that all defendants are jointly and severally liable for this amount. Thus, the proper method of analysis is not to focus on the unfairness of the mutual funds' profit at the expense of their purchasers—who have their own recourse for any wrongdoing—but on the strands of duty running to the corporation from the various individuals involved. The crux of the majority's holding is that the institutional defendants—Lehman Brothers, IDS, and the two mutual funds—and their employees—Simon, Sit, and Jundt—are within the sweep of fiduciary principles announced in *Diamond* v. *Oreamuno,* 24 N.Y.2d 494, 301 N.Y.S. 2d 78 (1969). But a careful examination of that case and the principles underlying it demonstrate that *Diamond* is wholly inapposite to this case.

In *Diamond,* the New York Court of Appeals dealt with a derivative action brought by a shareholder of Management Assistance, Inc. (MAI) against Oreamuno, chairman of the board of directors of the corporation, and Gonzalez, its president. The complaint charged that by virtue of

their corporate positions, these officers knew that a supplier's price increase had caused MAI's earnings to decrease by more than 75% during a one month period. According to the allegations, the two officers sold over 50,000 MAI shares at a price of $28 per share prior to public disclosure of the adverse earnings figures, after which the price per share plummetted to $11. In reviewing the Appellate Division's refusal to order dismissal of the complaint against Oreamuno and Gonzalez, Chief Judge Fuld stated at the outset that "the question presented—one of first impression in this court—is whether *officers and directors* may be held accountable to their corporation for gains realized by them from transactions in the company's stock as a result of their use of material inside information." 24 N.Y.2d at 496, 301 N.Y.S.2d at 79 (emphasis added). A careful reading of the *Diamond* opinion reveals that Oreamuno's and Gonzalez's liability in a stockholders' derivative action was grounded solely in their having breached a fiduciary duty owed by them to MAI as corporate officials.

The inapplicability of these principles to any of the appellees[2] is readily apparent. The complaints here are barren of any allegation that the appellees—or Sit or Jundt—occupied any position, such as officer, director, employee, or agent, which would create fiduciary obligations to Lum's. *Compare* Brophy v. Cities Service Co., 31 Del.

2. As noted in the majority opinion, the only defendants remaining on appeal are Lehman Brothers, IDS, the two mutual funds, and Simon. The district court dismissed the actions against Chasen for lack of personal jurisdiction, a holding not challenged on appeal. Accordingly, this court need not comment on the nature and extent of Chasen's liability to Lum's because of his conduct.

Ch. 241, 70 A.2d 5 (1949); Quinn v. Phipps, 93 Fla. 805, 113 So. 419 (1927). Liability in *Diamond* was predicated entirely on such a relationship, and in its absence, the *Diamond* rationale for liability ceases to exist.

In an effort to bridge this fatal gap, the majority, without any basis in law or fact, reasons that the appellees were involved in a "joint" or "common enterprise" with Chasen, president of Lum's, "to misuse confidential corporate information for their own enrichment." By use of this interesting, but nevertheless fictional, theory, they seek to foist upon the appellees liability to Lum's for Chasen's improper behavior. But the facts alleged in the complaints are a far cry from the "conscious parallelism" cases, drawn from the antitrust field, cited as authority in the majority opinion; the facts simply do not comport with the concept of a joint enterprise, a term which implies the existence of a prior plan to carry out a mutually beneficial project. The complaints, read in the most favorable light to the plaintiffs, disclose nothing more than a seemingly unsolicited and haphazard revelation of certain information which was useful in making investment decisions. There are ample remedies under the federal securities laws to punish this conduct. But, I am unable to understand on what basis the majority transforms the 'appellees' spontaneous conduct into a nefarious, prearranged, and ongoing scheme so that "joint" or "common enterprise" priciples can make them liable as fiduciaries of a corporation with which they have no relationship.

A primary authority upon which the majority relies, §312 of the American Law Institute's Restatement of Agency 2d, exposes the inappropriateness of holding the

appellees liable to Lum's for their conduct. Section 312 provides that "A person who, without being privileged to do so, intentionally causes or assists an agent to violate a duty to his principal is subject to liability to the principal." Although Comment *c* to this section speaks generally of receipt of confidential information by a third person from a principal's agent, the central element of liability is the third party's active and intentional aiding in the agent's violation of a duty owed to his principal. In this case, Chasen's duty to Lum's was to not disclose confidential corporate information. Yet there is not a word in the complaint charging that the appellees actively solicited the disclosure or that they had concocted a prearranged scheme with Chasen.[3] We are dealing here with an isolated transaction.

In the absence of any coherent legal theory, I cannot join my brothers in approving the use of the shareholders' derivative action device merely because, as my brothers candidly admit, to do so possibly may have a deterrent effect on "insider trading." Although developments in federal securities law indicate an expanding scope of liability for tippee traders, *see In re* Investors Management Co.,

3. It is of no small significance that in the *Diamond* litigation, the Appellate Division affirmed dismissal of the complaint against other MAI directors—fiduciaries to the corporation—who allegedly "approved, acquiesced in or ratified" Oreamuno's and Gonzalez's transactions. 29 A.D.2d 285, 287 N.Y.S.2d 300 (1968). Despite the majority's effort in a footnote to "distinguish" this disposition, I believe the Appellate Division's action is clearly dispositive of the point before us. If the New York courts would not impose liability upon a director—a fiduciary of the corporation—who took no affirmative steps to cause or assist in a breach of a fiduciary duty by the corporation's president, I fail to see by what logic it can be urged that New York courts would hold liable a non-fiduciary who did not cause or assist in the breach.

Securities and Exchange Commission Release No. 34-9267 (Jul. 29, 1971) (SEC sanctioning of institutional investors who sold a corporation's shares after the corporation's underwriter revealed adverse earnings results to them); *cf.* SEC v. Texas Gulf Sulphur Co., 446 F.2d 1301, 1308 (2d Cir. 1971), *cert. denied,* 404 U.S. 1005 (1972) (affirming district court order, in SEC injunctive suit, requiring a "tippor" to divest an amount equal to his tippees' profits), the impetus for developing this expanded federal law liability—whose exact nature and scope remain in a formative stage—is the need to maintain free and honest securities markets. This need appropriately is given great weight when we consider claims under the federal securities law. But it is inapposite in determining whether, *under state common law,* tippee trading is a breach of a fiduciary duty owed to the corporation whose shares are traded, and if so, whether such a breach is remediable through use of a shareholders' derivative action.

In these actions, where jurisdiction is grounded solely in diversity of citizenship, the parties and the majority agree that our duty is to apply the law of Florida. Yet because there are no pertinent Florida decisions, the majority focuses on a New York decision, Diamond v. Oreamuno, *supra.* Thus, liability is founded on the conclusion of two federal judges that the Florida Supreme Court, if the instant case was before it, would look to a New York decision and, in addition, would give an unprecedented expansive reading to that case.

Despite the manner in which the majority opinion convolutes the law and the facts in this case, a view that a

tippee is cloaked with state law fiduciary obligations to the corporation whose shares he trades is an unknown and untenable legal concept. Neither *Diamond*—itself a significant alteration of the common law principles applicable to an officer's or director's trading in his corporation shares[4]—nor the law of agency support such a holding. Nothing in the majority opinion tells us why or on what grounds a New York court would hold a tippee trader liable to the corporation for his profits under common law fiduciary principles, and the court exceeds its authority by substituting its own view of what state law ought to be, for what the state law actually is.

Moreover, since the outcome of this case turns, ultimately, upon Florida law, I fail to comprehend why my brothers refuse to utilize Florida's certified question statute, Fla. Stat. Ann. §25.031.[5] This enlightened law provides for certification to the Florida Supreme Court by a federal appellate court of an unresolved question of Florida law

4. *See* Note, 1970 Wis. L. Rev. 576, 577. Although not dispositive, this fact augurs against assuming the state courts could make the broad holding so readily attributed to them by the majority.

5. The supreme court of this state may, by rule of court, provide that, when it shall appear to the supreme court of the United States, to any circuit court of appeals of the United States, or to the court of appeals of the District of Columbia, that there are involved in any proceeding before it questions or propositions of the laws of this state, which are determinative of the said cause, and there are no clear controlling precedents in the decisions of the supreme court of this state, such federal appellate court may certify such questions or propositions of the laws of this state to the supreme court of this state for instructions concerning such questions or proposition of state law, which certificate the supreme court of this state, by written opinion, may answer.

This statutory authority has been implemented by Appellate Rule 4.61.

which is determinative of a case before it and on which there are no clear, controlling Florida Supreme Court precedents. The statute states that the court, by written opinion, then may answer the certified question. *See* Aldrich v. Aldrich, 375 U.S. 249 (1963); Green v. American Tobacco Co., 304 F. 2d 170 (5th Cir. 1962). The uncertainty inherent in the majority's speculation over what the Florida courts would decide if faced with this novel question of tippee liability under state common law fiduciary principles in a stockholders' derivative action would be dispelled authoritatively and finally.

Accordingly, I respectfully dissent.

Appendix B

Opinion of the District Court for the Southern District of New York, December 16, 1971 reported *sub nom.*, *Gildenhorn* v. *Lum's Inc.*, 355 F. Supp. 329 (S.D.N.Y. 1971)

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

70 Civ. 5733 HRT

JOSEPH GILDENHORN, as Guardian for CAROL ANN GILDENHORN,

Plaintiff,

against

LUM'S INC., MELVIN CHASEN, LEHMAN BROTHERS, INVESTORS DIVERSIFIED SERVICES, INC., INVESTORS VARIABLE FUND, INC., and IDS NEW DIMENSIONS FUND, INC.,

Defendants.

---

71 Civ. 1925 HRT

ANTONE F. GREGORIO,

Plaintiff,

against

LUM'S INC., MELVIN CHASEN, LEHMAN BROTHERS, INVESTORS DIVERSIFIED SERVICES, INC., EUGENE C. SIT, and JAMES R. JUNDT,

Defendants.

---

71 Civ. 4218 HRT

JACOB SCHEIN and MARVIN H. SCHEIN,

Plaintiffs,

against

MELVIN CHASEN, INVESTORS DIVERSIFIED SERVICES, INC., LEHMAN BROTHERS, BENJAMIN SIMON, INVESTORS VARIABLE PAYMENT FUND, INC., IDS NEW DIMENSIONS FUND, INC., EUGENE C. SIT, JAMES R. JUNDT, and LUM'S INC.,

Defendants.

Appendix B—Opinion of the District Court

TYLER, D.J.

Defendants in these consolidated actions have moved to dismiss plaintiffs' complaints upon the ground that they fail to state a claim upon which relief can be granted. Rule 12(b)(6) F.R. Civ. P. Alternatively, all defendants move this court to stay these actions pending a final determination in *Sanders* v. *Lum's, Inc. et al.,* 70 Civ. 5331, a related action pending before this court. Additionally, the individual defendants move that the complaints be dismissed as against them upon the ground that jurisdiction over their persons has not been obtained. Rules 4(e) and 12(b)(2), F.R. Civ. P.[1]

All three of these suits are derivative actions brought on behalf of Lum's Inc. ("Lum's"), a Florida corporation. Jurisdiction is claimed by virtue of diversity of citizenship. The plaintiffs' complaints are predicated on the same facts as *S.E.C.* v. *Lum's et al.,* 70 Civ. 5280, which is also pending before this court. Briefly stated, plaintiffs' claims are based on defendants' alleged misuse of confidential corporate information. The complaints charge that defendant Melvin E. Chasen, aware as president of Lum's that the firm's 1969 earnings would be lower than had been projected, telephoned from his Florida office to defendant Simon, who is employed in the Chicago, Illinois office of defendant Lehman Brothers, Inc., and told him of the earnings' decline. Simon then transmitted the information to

1. Defendants Sit and Jundt, apparently unaware that I have already granted their prior motions to dismiss by order dated October 25 of this year, once again seek the same relief. As they are no longer defendants in any of these actions, their applications will not be considered.

Sit, the portfolio manager at defendant IDS New Dimensions Fund ("Dimensions"), whose offices are in Minneapolis, Minnesota. Sit then conveyed the information to defendant Jundt, a manager and analyst for IDS Variable Payment Fund ("Variable"). It is further alleged that Sit and Jundt then caused Variable and Dimensions to sell their entire holdings in Lum's just before the public announcement of the decline in the 1969 earnings caused the stock to drop several points in trading on the New York Stock Exchange.

Plaintiffs make no argument that any of the federal securities acts would support a claim under the facts of this case. They do argue, however, that a claim for which relief can be granted can be made out under the recent decision of the New York Court of Appeals in *Diamond* v. *Oreamuno,* 24 N.Y. 2d 494, 301 N.Y.S. 2d 78 (1969). Briefly stated, that case held that corporate officers who learn of a drop in corporate earnings by virtue of their fiduciary positions and sell their shares of corporate stock before publishing information as to the loss will be liable to the corporation for any profits made thereby. Plaintiffs urge that Chasen be found liable under *Diamond* even though it is not alleged that he sold any Lum's stock belonging to him and that the remaining defendants be so held under either a "tippee" or general conspiracy theory.

Three issues, thus, are presented to this court by these motions, the first being a choice of law problem. The defendants argue that under the applicable choice of law provisions, these cases should be decided by Florida law. Plaintiffs oppose and urge that their complaints be tested

by New York law in general and by *Diamond* v. *Oreamuno, supra,* in particular. Assuming that *Diamond would apply,* this court would then have to determine whether the complaints herein can state a claim under the holding of that case. Finally, it must be decided whether the activities of the individual defendants fall within any of the provisions of the New York long-arm statute, CPLR §302(a), so as to allow out of state service to be effected upon them pursuant to CPLR §313.

In actions where jurisdiction is predicated on diversity of citizenship, this court must apply the choice of law rules of the State of New York. *Klaxon Co.* v. *Stentor Electric Mfg. Co.,* 313 U.S. 487 (1941). New York follows the general choice of law principle that the law of the state of incorporation governs the existence and extent of corporate fiduciary obligations as well as the liability for violations of such obligations. *Hausman* v. *Buckley,* 299 F.2d 696, 703 (2d Cir., 1962) and cases cited therein; *Norte & Co.* v. *Huffines,* 304 F. Supp. 1096, 1110 n.6 (S.D.N.Y., 1968). This rule was expressed in *Diamond* itself when the court stated that as regards the "* * * duties and obligations of directors and officers and their relation to the corporation and its shareholders * * * [t]he primary source of law in this area ever remains that of the state which created the corporation." *Diamond* v. *Oreamuno, supra,* at 503, 504, 301 N.Y.S. 2d at 35.

The same result would be reached by the "grouping of contacts" approach to choice of law in tort actions as enunciated in *Babcock* v. *Jackson,* 12 N.Y. 2d 473, 240 N.Y.S. 2d 743 (1963). Under this approach, a New York court will

apply the law of the state of the "strongest contacts with the cause of action." *Stockwell* v. *Reynolds & Co.*, 252 F. Supp. 215, 220 n.3 (S.D.N.Y., 1965). It appears from the pleadings that this case centers in Florida rather than in New York. Chasen, a Florida citizen, allegedly received and communicated the information from Florida. Lum's was incorporated, headquartered, and, at least theoretically, damaged in Florida. Most of the other contacts appear to be scattered about the midwest, the only contact with New York being several transactions over the New York Stock Exchange. Additionally, a New York court would give more weight to the Florida contacts under the "governmental interest" theory of choice of law enunciated in *Tooker* v. *Lopez*, 24 N.Y. 2d 569, 301 N.Y.S. 2d 519 (1969), because Florida has the paramount interest in defining and enforcing fiduciary obligations owing to corporations incorporated and doing business within its borders. Accordingly, I find that under any conceivable test, a New York court would apply Florida law to this case.

Under present Florida case law, a plaintiff in a derivative action must prove that the corporation has been damaged by the alleged breach of fiduciary trust. Although the highest court in that state has apparently not considered the matter, several District Courts of Appeal have held on various occasions that a complaint which fails "* * * to indicate both wrongful acts and damage to the corporation" must be dismissed. *Palma* v. *Zerby*, 189 So.2d 510, 511 (Fla. D.C. App., 1966), *cert. denied* 200 So.2d 814 (and cases cited therein).

While it is apparently required that the damage to a corporation be alleged, the Florida cases shed no light on

the specificity required for pleading corporate damage. Thus, though the Gildenhorn and Gregorio complaints might be insufficient under Florida law for failing to allege any damage to the corporation at all, the Schein complaint, which contains only a bare allegation that Lum's was damaged, might conceivably be held to he sufficient by a Florida court. Furthermore, I am not unmindful of the possibility that, were a Florida court to hear this case, *Diamond* v. *Oreamuno, supra,* would be argued to it. Because of the possibility that the *Diamond* rationale might be followed in Florida, it is desirable that this court determine whether these complaints state a claim under *Diamond* for which relief can be granted.

It is clear that the complaints in these actions go far beyond the narrow holding of *Diamond.* In that case, the New York Court of Appeals held that a corporate fiduciary is liable for profits which he realizes from a sale of stock motivated by inside information received by him in his corporate position. None of the defendants in these actions fit into this mold. Chasen, as president and chief operating officer of Lum's, was certainly a fiduciary of that corporation. None of the complaints, however, allege that he did anything more than pass the inside information to defendant Simon, and there are no allegations that Chasen sold any of his Lum's stock or derived any gain, monetary or otherwise, from the sales that ultimately occurred. On the other hand, the mutual fund defendants would have profited if, as alleged, they sold their 83,000 shares of Lum's stock on the basis of Chasen's inside information. It can scarcely be maintained, however, that the mutual fund defendants were officers or directors of Lum's or

owed any fiduciary duties whatsoever to that corporation. The broker-dealer defendants fail to come within either of the *Diamond* perameters as they were not fiduciaries of the corporation and did not profit by virtue of the sales.

Plaintiffs, of course, urge a more expansive view of *Diamond*. They point to portions of the opinion indicating that the purpose of the holding was to protect the corporation's interest in "* * * maintaining a reputation of integrity, an image of probity for its management and in insuring the continued public acceptance and marketability of its stock." *Diamond* v. *Oreamuno, supra,* at 499, 301 N.Y.S. 2d at 82. Thus, say plaintiffs, if the purpose of *Diamond* is to maintain a corporation's integrity on the securities exchanges, it should make no difference whether an officer or director sells his own stock or passes the inside information to others who in turn sell their stock and profit thereby. While the harm done to the corporation might be equal in either instance, there is evidence that *Diamond* was not intended to cover the latter situation. As Chief Judge Fuld explained, the purpose of that derivative action was to allow individual shareholders to be "* * * 'private attorney generals' to * * * enforce proper behavior of corporate officers." *Diamond* v. *Oreamuno, supra,* at 503, 301 N.Y.S. 2d at 85. It is implicit that the jurisdiction of these "private attorney generals" would be limited to the corporation in which they are shareholders. It could not, with any logic, be extended in a derivative action to cover outside individuals, corporations, or institutions who are subject ot other private and governmental restraints on their behavior. Furthermore, in affirming the dismissal of the

Diamond complaint against other board members who were alleged to have aided the defendants in concealing their activities, the New York Court of Appeals made it quite clear that *Diamond* extends only to corporate fiduciaries who actually profit by inside information and does not cover aiders and abettors and/or conspirators. In view of the fact that the New York Court of Appeals could not bring itself to find liability for inter-corporate conspirators, I fail to perceive how this court could extend *Diamond* to cover extra-corporate conspirators and tippees. Accordingly, I conclude that with regard to all defendants save Chasen, the complaints herein fail to state a claim for which relief can be granted.

On the other had, Chasen, as a corporate officer, might well come within the *Diamond* holding. Although it could be plausibly argued that *Diamond* would not apply to Chasen because of the failure to allege that he sold any stock and profited thereby, it might also be maintained that a New York court could find liability in light of the numerous statements in *Diamond* to the effect that the purpose of the holding is to prevent corporate misfeasance. This question, however, need not be reached because service of process upon Chasen was improper.

In diversity actions, this court's jurisdiction is determined by the law of the State of New York. Rule 4(d)(7), F.R. Civ. P. Because Chasen is not a New York resident and was not served in New York, jurisdiction of his person depends on the New York long-arm statute, CPLR §302(a). It is plaintiffs' assertion that jurisdiction was obtained over Chasen because he set in motion events which cul-

minated with the alleged sale of 83,000 shares of Lum's stock over an exchange located in New York. While I am aware that the scope of CPLR §302(a) has been broadly construed, I fail to see how it can be read to cover the facts in this case.

While it is settled that one can "transact business" within the meaning of CPLR §302(a)(1) through an agent, *Parke-Bernet Galleries, Inc.* v. *Franklyn,* 26 N.Y.2d 13, 308 N.Y.S. 2d 337 (1970), a New York Court would decline jurisdiction of a defendant who merely telephones a single order from outside the state. *Katz & Son Billiard Prods.* v. *Correale & Sons,* 20 N.Y. 2d 903, 285 N.Y.S. 2d 871 (1967). It seems obvious that Chasen, who did not place the order to sell the Lum's stock in question, did not "purposefully" avail himself "of the privilege of conducting activities" within New York, thereby "invoking the benefits and protections of its laws." *Hanson* v. *Denckla,* 357 U.S. 235, 253 (1958).

Plaintiffs next argue that the sale of stock over a national exchange in New York was a "tortious act within the state" and that jurisdiction could be found under CPLR §302(a)(2). While such a sale will confer jurisdiction in some cases, *Cooper* v. *North Jersey Trust Co. of Ridgewood, New Jersey,* 250 F. Supp. 237 (S.D.N.Y., 1965), CPLR §302(a)(2) can apply only where the non-resident defendant committed the tort in New York. That the alleged tort here may have been completed or "came to rest" in New York will not confer jurisdiction unless the acts or omissions complained of also occurred in New York. *Feathers* v. *McLucas,* 15 N.Y. 2d 426, 261 N.Y.S. 2d 8

(1965). *Cooper* v. *North Jersey Trust Co. etc., supra,* is not inconsistent as the defendants in that case were physically in New York when they allegedly committed the tort there in issue. As it is nowhere alleged that Chasen committed a tortious act in New York, no jurisdiction of his person can be claimed under CPLR §302(a)(2).

Finally, there can be no jurisdiction under CPLR §302 (a)(3). As the statute clearly states, the tortious act must cause injury to persons or property in New York. Insofar as none of the non-resident plaintiffs in these cases have alleged that any injury occurred in New York, their invocation of this provision is futile.

Defendant Chasen's motion to dismiss is granted on the ground that no jurisdiction was ever obtained of his person. Rule 12(b)(2) F.R. Civ. P. The motions of the remaining defendants to dismiss under Rule 12(b)(6) F.R. Civ. P. are hereby granted. In view of these rulings, defendants' alternative motion for a stay of these actions need not be reached.

Settle orders accordingly.

Dated: December 15, 1971

H. R. Tyler, Jr.
U.S.D.J.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-495

INVESTORS DIVERSIFIED SERVICES, INC., INVESTORS VARIABLE PAYMENT FUND, INC., and IDS NEW DIMENSIONS FUND, INC.,
Petitioners,

v.

JACOB SCHEIN and MARVIN H. SCHEIN,
Respondents.

INVESTORS DIVERSIFIED SERVICES, INC.,
Petitioner,

v.

ANTONE F. GREGORIO
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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September 17, 1973

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IN THE

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No.

INVESTORS DIVERSIFIED SERVICES, INC., INVESTORS VARIABLE PAYMENT FUND, INC., and IDS NEW DIMENSIONS FUND, INC.,
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v.

ANTONE F. GREGORIO
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

The petitioners, Investors Diversified Services, Inc., Investors Variable Payment Fund, Inc., and IDS New Dimensions Fund, Inc., respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit entered in this proceeding on May 10, 1973.

Opinions Below

The opinion of the Court of Appeals, reported at 478 F.2d 817, and the opinion of the District Court, reported at 335 F. Supp. 329, appear in the Appendix hereto.

Jurisdiction

The judgment of the Court of Appeals for the Second Circuit was entered on May 10, 1973. A timely petition for rehearing with a suggestion for rehearing *in banc* was denied on June 18, 1973, and this petition was filed within 90 days of that date. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

Questions Presented

1. Did the Court of Appeals exceed the constitutional limitations expounded in *Erie R.R. Co.* v. *Tompkins,* 304 U.S. 64 (1938), by holding, in this diversity case governed by Florida law, that a Florida corporation has a common law right of action for profits made by a non-fiduciary "tippee" in selling the corporation's stock on the basis of material, non-public information, when no such common law right is known to the law of Florida or any other state?

2. May a federal court of appeals decide an important and controlling question of state law, for which admittedly no precedent or authority remotely in point can be found, without certifying the question to the highest court of the state when the state has made a procedure available for such occasions?

Constitutional Provision Involved

Constitution of the United States, Amendment X

"The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."

Statutory Provision Involved

Florida Annotated Statutes

"§ 25.031

Supreme court authorized to receive and answer certificates as to state laws from federal appellate courts.

The supreme court of this state may, by rule of court, provide that, when it shall appear to the supreme court of the United States, to any circuit court of appeals of the United States, or to the court of appeals of the District of Columbia, that there are involved in any proceeding before it questions or propositions of the laws of this state, which are determinative of the said cause, and there are no clear controlling precedents in the decisions of the supreme court of this state, such federal appellate court may certify such questions or propositions of the laws of this state to the supreme court of this state for instructions concerning such questions or propositions of state law, which certificate the supreme court of this state, by written opinion, may answer."

Statement of the Case

Respondents Jacob and Marvin H. Schein and Antone F. Gregorio, brought these actions derivatively on behalf of Lum's, Inc., ("Lum's"), a Florida corporation engaged in the fast-food franchising business. Named as defendants

were Melvin Chasen, Lum's chief executive officer; the brokerage firm of Lehman Brothers and one of its registered representatives, Benjamin Simon;[1] Investors Diversified Services, Inc. ("IDS"), and two mutual funds advised by IDS[2] and their portfolio managers, Eugene Sit and James Jundt. The complaints, pending in the United States District Court for the Southern District of New York,[3] assert no claim under federal law. Jurisdiction was founded upon diversity of citizenship. The parties now agree that Florida law governs.

The complaints allege, in summary, that on or about January 5, 1970, Chasen, Lum's chief executive officer, learned that the company's earnings for fiscal 1970 would be $0.76 per share rather than the figure of approximately $1.00 to $1.10 per share which Chasen had announced in November of 1969. On or about January 8, 1970, and prior to any public announcement, Chasen telephoned Simon at Lehman Brothers and imparted this information. Simon immediately called Sit, the portfolio manager of IDS New Dimensions Fund, and passed on the news. Sit disclosed the information to Jundt, a portfolio manager of Investors Variable Payment Fund, and on January 9, 1970, the two portfolio managers caused their respective mutual funds to sell a total of 83,000 shares of Lum's common stock at approximately $17.50 per share. Later that day, the New York Stock Exchange halted trading in Lum's stock pending an announcement from the company as to its projected earnings. When trading resumed on January 12, 1970, the opening price was $14.00 per share. (*Schein* Complaint ¶¶ 16-24; *Gregorio* Amended Complaint ¶ 13-20).

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[1] Mr. Simon is not not named as a defendant in the *Gregorio* action.

[2] The two mutual funds are not named as defendants in the *Gregorio* action.

[3] The *Gregorio* action, commenced in the Northern District of Illlinois, was transferred to the Southern District of New York on consent.

In the *Schein* case, respondents assert that petitioners "are liable to Lum's for their unlawful profits (including commissions) and are liable to Lum's for the damages it sustained thereby." (Schein Complaint ¶ 25) In the *Gregorio* case, respondent seeks to require petitioners to account to Lum's for their profits, but does not allege that Lum's sustained any damages by reason of the acts complained of. (*Gregorio* Amended Complaint ¶ 22)

Petitioners moved to dismiss the complaint under Rule 12(b)(6), F.R.C.P., for failure to state a claim upon which relief could be granted under the applicable Florida law. Respondents urged that their complaints be tested under New York law, rather than Florida law, and specifically under a recent decision of the New York Court of Appeals, *Diamond* v. *Oreamuno,* 24 N.Y.2d 494, 301 N.Y.S. 2d 78 (1969). The District Court ruled that Florida law applied but nevertheless considered whether the complaints stated a claim under *Diamond* "because of the possibility that the *Diamond* rationale might be followed in Florida." In holding that *Diamond* did not afford any basis for a claim, the court said:

> "It is clear that the complaints in these actions go far beyond the narrow holding of *Diamond.* In that case, the New York Court of Appeals held that a corporate fiduciary is liable for profits which he realizes from a sale of stock motivated by inside information received by him in his corporate position. None of the defendants in these actions fit into this mold.
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> "As Chief Judge Fuld explained, the purpose of that derivative action was to allow individual shareholders to be '. . . "private Attorney General[s]" to . . . enforce proper behavior on the part of corporate officials.' Diamond *v.* Oreamuno, *supra,* at 503, 301 N.Y.S. 2d at 85, 248 N.E.2d at 915. It is implicit that the jurisdiction of these 'private attorney generals' would be limited to the corporation in which they are

shareholders. It could not, with any logic, be extended in a derivative action to cover outside individuals, corporations, or institutions who are subject to other private and governmental restraints on their behavior. Furthermore, in affirming the dismissal of the *Diamond* complaint against other board members who were alleged to have aided the defendants in concealing their activities, the New York Court of Appeals made it quite clear that *Diamond* extends only to corporate fiduciaries who actually profit by inside information and does not cover aiders and abettors and/or conspirators. In view of the fact that the New York Court of Appeals could not bring itself to find liability for inter-corporate conspirators, I fail to perceive how this court could extend *Diamond* to cover extra-corporate conspirators and tippees. Accordingly, I conclude that with regard to all defendants save Chasen, the complaints herein fail to state a claim for which relief can be granted." (335 F. Supp. at 333-34, Appendix at 5A-7A)

The District Court thereupon dismissed the complaints.

The Court of Appeals for the Second Circuit reversed, Judge Kaufman dissenting. Noting respondents' concession that Florida law governed but contained no cases in point, the Court first satisfied itself that "the Florida court has never faced the precise issues which are present in this action." (478 F.2d at 820, 821, Appendix at 17A.) It then proceeded to "turn for guidance" to the *Diamond* case, and purporting to 'view the case as the Florida court would probably view it,' ruled that the "stretch" of *Diamond* reached the defendants in this case. (478 F.2d at 821, 822, Appendix at 19A-20A.)

In his dissent Judge Kaufman pointed out that *Diamond* was grounded solely upon the breach of a fiduciary duty owed to a corporation by its officers and directors and that no such fiduciary relationship existed between Lum's and

petitioners. He concluded that "the court exceeds its authority by substituting its own view of what [New York] state law ought to be, for what the state law actually is," an excess of authority compounded by its speculation that the Florida Supreme Court "would look to a New York decision and, in addition, would give an unprecedented expansive reading to that case." (478 F.2d at 828, Appendix at 30A-31A.)

Finally, Judge Kaufman could not comprehend why his brothers refused to utilize Florida's certified question statute, Fla. Stat. Ann. §25.031.

> "The uncertainty inherent in the majority's speculation over what the Florida courts would decide if faced with this novel question of tippee liability under state common law fiduciary principles in a stockholders' derivative action would be dispelled authoritatively and finally." (*Ibid.*, Appendix at 32A)

REASONS FOR GRANTING THE WRIT

I

In deciding this case the Court of Appeals transgressed the constitutional boundaries of federal judicial power.

Under *Erie R.R. Co.* v. *Tompkins*, 304 U.S. 64 (1938), which commands the federal courts to recognize and preserve the autonomy and independence of the States in obedience to the Constitution, it was the duty of the Court of Appeals to ascertain the law of Florida and apply it to the facts of this case. It made no real effort to do so. Instead, seizing upon and improperly extending a single, novel decision of the New York Court of Appeals, it fashioned out of whole cloth a new remedy for violation of the federal securities laws which relate to insider trading.

All of this is apparent from the face of the opinion, which does not evidence any genuine concern for the law or policy of Florida.

The majority describes its investigation into Florida law as a "foray." (478 F.2d at 821, Appendix at 17A) The word is apt. It cites only two Florida cases: *Quinn* v. *Phipps*, 93 Fla. 805, 113 So. 419 (1927) and *Palma* v. *Zerby*, 189 So. 2d 510 (Fla. App. 1966), cert. denied, 200 So. 2d 814 (Fla. 1967). It dismisses the latter as a per curiam opinion of a lower Florida court. (478 F.2d at 824, fn. 9, Appendix at 23A) *Quinn* v. *Phipps* is cited for the proposition that the concept of a fiduciary under Florida law extends not only to "technical fiduciaries" but to others who became "fiduciaries" through the acquisition of confidential information which is owned by someone else. (*Id.* at 823, Appendix at 21A) But *Quinn* v. *Phipps*, which concerns the liability of a real estate broker who purchased property for himself instead of the client on whose behalf he had agreed to transmit an offer, involves no more than a run-of-the-mill breach of the fiduciary duty owed by an agent to his principal.

There is no discussion in the opinion of the Florida law respecting the rights of corporations and the obligations of their directors and officers, the willingness or not of the Florida court to create new common-law remedies without statutory basis, the degree of its concern with problems of insider trading in securities, the extent to which it looks to the law of New York in cases without Florida precedent, or any other subject that might give some clue as to how "the Florida court would probably view" the case. The nod to *Erie* is perfunctory. With all due respect, it must be said that the majority opinion displays an extraordinary lack of sensitivity to the law and policy of Florida.

By contrast, the opinion is replete with federal law and policy. No less than 25 federal cases are cited, a large

number of them dealing with liability under the antifraud provisions of the federal securities laws. The court praises *Diamond's* "prophylactic effect of providing a disincentive to insider trading" (478 F.2d at 823, Appendix at 20A) and relies on the expression in numerous federal cases of a policy of "[p]reventing those who are privy to confidential inside information from using it to their own advantage." (*Id.* at 825, Appendix at 24A.)

It is plain beyond peradventure, we respectfully submit, that the Court of Appeals, ignoring Florida law, has taken the opportunity provided by this case to announce, in effect, a new rule of federal common law in support of the policy of the federal securities laws. Such a course is forbidden by *Erie,* in which Mr. Justice Brandeis said:

> "There is no federal general common law. Congress has no power to declare substantive rules of common law applicable to a state whether they be local in their nature or "general," be they commercial law or part of the law of torts." And no clause in the Constitution purports to confer such a power upon the federal courts." 304 U.S. at 78.

cf. *West* v. *American Telephone & Telegraph Co.,* 311 U.S. 223 (1940).

Even in treating New York law, the court may have exceeded what is permissible under *Erie.* It looked at only one New York case, *Diamond,* which the New York Court of Appeals itself recognized to be one of first impression, 24 N.Y. 2d at 496, 301 N.Y. Supp. 2d at 79. *Diamond* held, simply, that corporate officers and directors who profit from using inside information to trade in their corporation's securities have wrongfully exploited a corporate asset for their personal benefit and must, as fiduciaries of the corporation, surrender their profits to it. The legal basis for imposing such liability rests on violation of the fiduciary obligation that an officer or director owes to his corpora-

tion. The policy reason for imposing it, even though the corporation could not lawfully have profited itself from use of the inside information, stems from its deterrent effect and the interest of the corporation in preserving its good name.

> "When officers and directors abuse their position in order to gain personal profits, the effect may be to cast a cloud on the corporation's name, injure stockholder relations and undermine public regard for the corporation's securities." 24 NY 2d at 499, 301 N.Y. Supp. 2d at 82.

Thus, in creating a new common-law remedy for New York corporations, the New York court built upon principles of the law of fiduciaries in order to vindicate what it regarded as a significant corporate interest.

In "stretching" *Diamond* to require remote "tippees" to make over their profits to the corporation, the court below abandoned the rationale of *Diamond* and overlooked the limitations established by the New York court in refusing to extend *Diamond* liability to officers and directors who approved, acquiesced in or ratified the insider transactions. (See Judge Kaufman's dissenting opinion, 478 F.2d at 827, fn. 3, Appendix at 29A) Petitioners were not officers or directors of Lums. They had no relationship of any kind with Lums, let alone a fiduciary relationship, other than (in the case of the mutual funds only) owning some of its shares. Thus the legal basis of *Diamond* is non-existent. Nor can it be argued seriously that their use of inside information to sell Lum shares injured its good name. Thus there is no corporate interest to be vindicated. Plainly, *Diamond* does not justify the "stretch", and the court below cited no other New York case.

Nevertheless, the court below assumed not only that the Supreme Court of Florida would follow *Diamond,* a unique case of first impression, and create a new common-law liabil-

ity for directors and officers of Florida corporations, but would go on to "stretch" *Diamond* beyond its rationale and stated limitations by resorting to the "tortured reasoning" (Appendix at 25A) of the majority opinion. Nothing in that opinion suggests why the Supreme Court of Florida would do any such thing.

In the absence of any indication whatsoever that the Florida court would fashion a new common-law rule without precedent in Florida or any other jurisdiction, it was the clear duty of the Court of Appeals either to dismiss the complaints for failure to state a claim under Florida law or to certify the question to the Supreme Court of Florida under the procedure authorized by Florida statute. (Fla. Ann. Stat. 25.031) For the Florida certification statute expresses a clear Florida preference that the federal appellate courts abstain from attempting to pronounce on Florida law where there are no clear controlling precedents. No other course would comport with *Erie*.

II

The refusal of the Court of Appeals to avail itself of the Florida certification procedure conflicts with decisions in other circuits.

There can be no real doubt that if the important question controlling this case had been presented to the Court of Appeals for the Fifth Circuit, that court would have certified it to the Supreme Court of Florida and obtained an authoritative determination binding not just in the Fifth Circuit but in the Second Circuit and every other federal jurisdiction where the question might arise. Such certification has been the uniform and successful practice in the Fifth Circuit ever since 1960, when this Court, in *Clay* v. *Sun Insurance Office*, 363 U.S. 207 (1960) ordered certifica-

tion of questions of Florida insurance law even though the only judge to rule on the local law question was experienced in Florida law and had been supported in his interpretation by the Florida Attorney-General.*

The occasions on which the Fifth Circuit has taken advantage of the Florida certification procedures are detailed in *Boyd* v. *Bowman,* 455, F. 2d 927, n. 1 (5th Cir. 1972). It has repeatedly lavished praise on the procedure, *e.g.,* in *Martinez* v. *Rodriquez,* 410 F. 2d 729 (5th Cir. 1969), where the court said:

> "We would be remiss if we did not once again seize the opportunity to extol the virtues of the Florida certification procedure. For example, while this Court following the footsteps of the stalwarts below might have reached the same conclusion as that of the Florida Court with respect to the issue in this case, our decision would have had no assurance of predictable correctness. No matter how many Federal Judges, trial, appellate, three-Judge panel, or the full panoply of the court en banc, any decision would have been an *Erie*-guess. Now the guesswork has been eliminated, and we are quickly presented with a definitive explication of Florida law." (410 F. 2d at 730)

It is noteworthy that the Fifth Circuit relies on certification of doubtful questions even though its judges may be presumed to have a familiarity with Florida law and judicial policy far greater than judges of the Second Circuit. For, as the Fifth Circuit acknowledges, it has been "saved from numerous wrong guesses." *Id.* at 731, fn. 5. The Florida court has rejected the Fifth Circuit's interpretation

* Other Circuits have also used a State certification procedure. See, *e.g., Ford* v. *Black Mountain Tramways, Inc.,* 110 N.H. 20, 259 A. 2d 129 (1969). District Courts in a number of Circuits have certified questions where the State law makes certification available to the lower federal courts. See, *e.g., Pierce* v. *Secretary of U.S. Dept. of Health, Ed. & Welf.,* 302 F. Supp. 508 (D. Me. 1969)

of Florida law in cases where it did not resort to certification. Compare, for example, *Emerson* v. *Holloway Concrete Prod. Co.*, 292 F.2d 271, 275 (5th Cir. 1960) with *Weed* v. *Bilbrey*, 201 So. 2d 771, 774 (2d D.C.A. Fla. 1967). A score sheet of State court rejections of federal court decisions as of 1967 was supplied by Judge Brown in his dissent in *W. S. Ranch Co.* v. *Kaiser Steel Corp.*, 388 F.2d 257, 264-65 and fns. (10th Cir. 1967), *rev'd*, 391 U.S. 593 (1968).

The value of certification resides, of course, not only in preventing the rejections that do occur but perhaps even more in avoiding the possibility that rejection will occur and thereby removing the uncertainty and confusion that must prevail until the State court of last resort has had an opportunity to speak.

The route of certification provides an easy and satisfactory resolution of the recurring conflict between the duty of a federal court to adjudicate with reasonable dispatch every case in which its jurisdiction has been properly invoked and the undesirability of its attempting to predict State law, particularly in areas that impinge on important State policy, when the State precedents are cloudy, conflicting or, as here, altogether lacking. *Meredith* v. *Winter Haven*, 320 U.S. 228 (1943), in which this Court condemned the Fifth Circuit's dismissal of a complaint without prejudice to proceeding in the State court because the law of Florida applicable to the validity of a municipal bond issue was not clearly settled, represents one pole of the conflict. This Court there, with two dissents, came down hard on the duty of federal courts to decide questions of State law

> "when necessary for the disposition of a case brought to it for decision, although the highest court of the state had not answered them, the answers were difficult and the character of the answers which the highest state courts might ultimately give remained uncertain." (320 U.S. at 237-38)

The other pole is represented by a series of cases in which this Court has commanded abstention by the lower federal court pending determination of the State law question in a State court proceeding, pending or to be brought.

In *Railroad Commission* v. *Pullman Co.*, 312 U.S. 496 (1941), this Court reversed an injunction granted by the federal district court against an order of the Texas Railroad Commission and remanded the case with instructions to retain the complainant's bill pending the determination of proceedings to be brought with reasonable promptness in the state court to determine whether the Commission's order was lawful. Mr. Justice Frankfurter noted that "no matter how seasoned the judgment of the district court may be, it cannot escape being a forecast rather than a determination" and that "the last word . . . belongs neither to us nor to the district court but to the supreme court of Texas." There, abstention avoided the "needless friction with state policies" that might result from a tentative construction of a state statute as well as the "friction of a premature constitutional adjudication." (312 U.S. at 499-500)

In *Louisiana P. & L. Co.* v. *Thibodaux City*, 360 U.S. 25 (1959), over the vigorous dissent of three justices who maintained that the decision was squarely contrary to *Meredith*, this Court directed abstention in order to permit the Supreme Court of Louisiana to interpret an eminent domain statute. Holding that this course did not constitute an abrogation of judicial duty but a wise and productive discharge of it, the Court said:

> "We have increasingly recognized the wisdom of staying actions in the federal courts pending determination by a state court of decisive issues of state law." (360 U.S. at 27)

More recently, in *Kaiser Steel Corp.* v. *W. S. Ranch Co.*, 391 U.S. 593 (1968), abstention was ordered *per curiam* in a

suit for trespass in order to obtain a New Mexico determination of the law relating to water rights in that state:

> "Sound judicial administration requires that the parties in this case be given the benefit of the same rule of law which will apply to all other businesses and landowners connected with the use of this vital state resource." (391 U.S. at 594)

While it is apparent that this Court has been sympathetic to abstention in a range of cases extending well beyond avoidance of premature constitutional adjudication and needless friction with state policy, it remains true that, in view of its drawbacks, abstention requires justification by special circumstances which must be considered on an *ad hoc* basis. The drawbacks of abstention do not exist under certification. Under certification there is no relinquishment of diversity jurisdiction and hence no conflict with *Meredith*. The federal court remains in control of the case, deciding all issues of fact and framing the questions of law. Nor are the delay and added expense to litigants which inevitably accompany abstention a feature of certification. The Fifth Circuit has vouched for the promptness with which its questions are answered by the Florida Supreme Court. The six months' wait noted by the Fifth Circuit in *Martinez* v. *Rodriquez*, 410 F.2d at 731, fn. 7, may be compared with the seven months that elapsed between argument and decision in this case. By relieving the federal court from wrestling with questions of state law which are definitively unanswerable by it, certification may well speed up the decisional process.

The Fifth Circuit experience has tested and proven the practicability and value of the Florida certification procedure. Since *Clay, Supra*, p. 11, this Court has twice directed its use on its own initiative. *Dresner* v. *City of Tallahassee*, 375 U.S. 136 (1963); *Aldrich* v. *Aldrich*, 375

U.S. 249 (1963). Certification procedures, though less frequently availed of, exist in a number of other states.* Appropriate action by this Court would undoubtedly stimulate the use of such other state procedures and lead to their enactment by other States.

We therefore respectfully submit that, as a matter of sound judicial administration, it should be incumbent on the federal courts, where a certification procedure has been made available by a state, to make use of that procedure to obtain authoritative answers to significant questions of state law for which no clear precedent can be found. In any event, it was incumbent upon the court below to certify the question before it to the Florida Supreme Court, as the Fifth Circuit would have done, rather than to indulge in unfounded assumptions as to how the Florida court would act and, in effect create new federal common law.

The simple fact is that no one knows or can know whether the decision of the court below is in accord with the law of Florida. Only the Florida Supreme Court can answer that question. Under the Florida statute that court was prepared to do so. The failure of the court below to follow the Florida certification route, which would enable it to learn the substantive law of Florida, is nothing more or less than a rejection by it of *Erie*.

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* Colorado—Rule 21.1, Appellate Rules; Hawaii Rev. Stat. § 602.36; Maine Rev. Stat. Ann., Tit. 4, § 57; Montana—Rule 1, Rules of the Montana Supreme Court; New Hampshire Rev. Stat. Ann. § 490; Washington Rev. Code Ann. § 2.60

CONCLUSION

For these reasons, this petition for a writ of certiorari should be granted.

September 17, 1973

Respectfully submitted,

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APPENDIX

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

Nos. 70 Civ. 5733, 71 Civ. 1925 and 4218

JOSEPH GILDENHORN, as Guardian for Carol Ann Gildenhorn,

Plaintiff,

v.

LUM'S INC., *et al.*,

Defendants.

ANTONE F. GREGORIO,

Plaintiff,

v.

LUM'S INC., *et al.*,

Defendants.

JACOB SCHEIN and MARVIN H. SCHEIN,

Plaintiffs,

v.

MELVIN CHASEN *et al.*,

Defendants.

December 15, 1971.

TYLER, *District Judge*

Defendants in these consolidated actions have moved to dismiss plaintiffs' complaints upon the ground that they fail to state a claim upon which relief can be granted. Rule 12(b) (6) F.R. Civ.P. Alternatively, all defendants move this court to stay these actions pending a final determina-

tion in *Sanders* v. *Lum's Inc. et al.*, 70 Civ. 5331, a related action pending before this court. Additionally, the individual defendants move that the complaints be dismissed as against them upon the ground that jurisdiction over their persons has not been obtained. Rules 4(e) and 12(b)(2), F.R.Civ.P.[1]

All three of these suits are derivative actions brought on behalf of Lum's Inc. ("Lum's"), a Florida corporation. Jurisdiction is claimed by virtue of diversity of citizenship. The plaintiffs' complaints are predicated on the same facts as *S.E.C.* v. *Lum's et al.*, 70 Civ. 5280, which is also pending before this court. Briefly stated, plaintiffs' claims are based on defendants' alleged misuse of confidential corporate information. The complaints charge that defendant Melvin E. Chasen, aware as president of Lum's that the firm's 1969 earnings would be lower than had been projected, telephoned from his Florida office to defendant Simon, who is employed in the Chicago, Illinois office of defendant Lehman Brothers, Inc., and told him of the earnings' decline. Simon then transmitted the information to Sit, the portfolio manager at defendant IDS New Dimensions Fund ("Dimensions"), whose offices are in Minneapolis, Minnesota. Sit then conveyed the information to defendant Jundt, a manager and analyst for IDS Variable Payment Fund ("Variable"). It is further alleged that Sit and Jundt then caused Variable and Dimensions to sell their entire holdings in Lum's just before the public announcement of the decline in the 1969 earnings caused the stock to drop several points in trading on the New York Stock Exchange.

1. Defendants Sit and Jundt, apparently unaware that I have already granted their prior motions to dismiss by order dated October 25 of this year, once again seek the same relief. As they are no longer defendants in any of these actions, their applications will not be considered.

Plaintiffs make no argument that any of the federal securities acts would support a claim under the facts of this case. They do argue, however, that a claim for which relief can be granted can be made out under the recent decision of the New York Court of Appeals in *Diamond* v. *Oreamuno*, 24 N.Y.2d 494, 301 N.Y.S.2d 78, 248 N.E.2d 910 (1969). Briefly stated, that case held that corporate officers who learn of a drop in corporate earnings by virtue of their fiduciary positions and sell their shares of corporate stock before publishing information as to the loss will be liable to the corporation for any profits made thereby. Plaintiffs urge that Chasen be found liable under *Diamond* even though it is not alleged that he sold any Lum's stock belonging to him and that the remaining defendants be so held under either a "tippee" or general conspiracy theory.

Three issues, thus, are presented to this court by these motions, the first being a choice of law problem. The defendants argue that under the applicable choice of law provisions, these cases should be decided by Florida law. Plaintiffs oppose and urge that their complaints be tested by New York law in general and by *Diamond* v. *Oreamuno, supra*, in particular. Assuming that *Diamond* would apply, this court would then have to determine whether the complaints herein can state a claim under the holding of that case. Finally, it must be decided whether the activities of the individual defendants fall within any of the provisions of the New York long-arm statute, CPLR § 302(a), so as to allow out of state service to be effected upon them pursuant to CPLR § 313.

In actions where jurisdiction is predicated on diversity of citizenship, this court must apply the choice of law rules of the State of New York. *Klaxon Co.* v. *Stentor Electric Mfg. Co.*, 313 U. S. 487, 61 S.Ct. 1020, 85 L.Ed. 1477 (1941). New York follows the general choice of law principle that the law of the state of incorporation governs the existence

and extent of corporate fiduciary obligations as well as the liability for violations of such obligations. *Hausman* v. *Buckley*, 299 F.2d 696, 703 (2d Cir., 1962) and cases cited therein; *Norte & Co.* v. *Huffines*, 304 F.Supp. 1096, 1110 n.6 (S.D.N.Y., 1968). This rule was expressed in *Diamond* itself when the court stated that as regards the ". . . duties and obligations of directors and officers and their relation to the corporation and its shareholders . . . [t]he primary source of the law in this area ever remains that of the State which created the corporation." *Diamond* v. *Oreamuno, supra*, at 503, 504, 301 N.Y.S.2d at 85, 248 N.E.2d at 915.

The same result would be reached by the "grouping of contacts" approach to choice of law in tort actions as enunciated in *Babcock* v. *Jackson*, 12 N.Y.2d 473, 240 N.Y.S.2d 743, 191 N.E.2d 279 (1963). Under this approach, a New York court will apply the law of the state of the "strongest contacts with the cause of action." *Stockwell* v. *Reynolds & Co.*, 252 F.Supp. 215, 220 n.3 (S. D.N.Y., 1965). It appears from the pleadings that this case centers in Florida rather than in New York. Chasen, a Florida citizen, allegedly received and communicated the information from Florida. Lum's was incorporated, headquartered, and, at least theoretically, damaged in Florida. Most of the other contacts appear to be scattered about the midwest, the only contact with New York being several transactions over the New York Stock Exchange. Additionally, a New York court would give more weight to the Florida contacts under the "governmental interest" theory of choice of law enunciated in *Tooker* v. *Lopez*, 24 N.Y.2d 569, 301 N.Y.S.2d 519, 249 N.E.2d 394 (1969), because Florida has the paramount interest in defining and enforcing fiduciary obligations owing to corporations incorporated and doing business within its borders. Accord-

ingly, I find that under any conceivable test, a New York court would apply Florida law to this case.

Under present Florida case law, a plaintiff in a derivative action must prove that the corporation has been damaged by the alleged breach of fiduciary trust. Although the highest court in that state has apparently not considered the matter, several District Courts of Appeal have held on various occasions that a complaint which fails ". . . to indicate both wrongful acts and damage to the corporation" must be dismissed. *Palma* v. *Zerbey,* 189 So. 2d 510, 511 (Fla.App., 1966), cert. denied 200 So.2d 814. (and cases cited therein.)

While it is apparently required that the damage to a corporation be alleged, the Florida cases shed no light on the specificity required for pleading corporate damage. Thus, though the Gildenhorn and Gregorio complaints might be insufficient under Florida law for failing to allege any damage to the corporation at all, the Schein complaint, which contains only a bare allegation that Lum's was damaged, might conceivably be held to be sufficient by a Florida court. Furthermore, I am not unmindful of the possibility that, were a Florida court to hear this case, *Diamond* v. *Oreamuno, supra.,* would be argued to it. Because of the possibility that the *Diamond* rationale might be followed in Florida, it is desirable that this court determine whether these complaints state a claim under *Diamond* for which relief can be granted.

It is clear that the complaints in these actions go far beyond the narrow holding of *Diamond.* In that case, the New York Court of Appeals held that a corporate fiduciary is liable for profits which he realizes from a sale of stock motivated by inside information received by him in his corporate position. None of the defendants in these actions fit into this mold. Chasen, as president and chief operating officer of Lum's, was certainly a fiduciary of that corpo-

ration. None of the complaints, however, allege that he did anything more than pass the inside information to defendant Simon, and there are no allegations that Chasen sold any of his Lum's stock or derived any gain, monetary or otherwise, from the sales that ultimately occurred. On the other hand, the mutual fund defendants would have profited if, as alleged, they sold their 83,000 shares of Lum's stock on the basis of Chasen's inside information. It can scarcely be maintained, however, that the mutual fund defendants were officers or directors of Lum's or owed any fiduciary duties whatsoever to that corporation. The broker-dealer defendants fail to come within either of the *Diamond* perimeters as they were not fiduciaries of the corporation and, did not profit by virtue of the sales.

Plaintiffs, of course, urge a more expansive view of *Diamond*. They point to portions of the opinion indicating that the purpose of the holding was to protect the corporation's interest in ". . . maintaining a reputation of integrity, an image of probity, for its management and in insuring the continued public acceptance and marketability of its stock." *Diamond* v. *Oreamuno, supra,* at 499, 301 N.Y.S.2d at 82, 248 N.E.2d at 912. Thus, say plaintiffs, if the purpose of *Diamond* is to maintain a corporation's integrity on the securities exchanges, it should make no difference whether an officer or director sells his own stock or passes the inside information to others who in turn sell their stock and profit thereby. While the harm done to the corporation might be equal in either instance, there is evidence that *Diamond* was not intended to cover the latter situation. As Chief Judge Fuld explained, the purpose of that derivative action was to allow individual shareholders to be ". . . 'private Attorney General[s]' to . . . enforce proper behavior on the part of corporate officials." *Diamond* v. *Oreamuno, supra,* at 503, 301 N.Y.S.2d at 85, 248

N.E.2d at 915. It is implicit that the jurisdiction of these "private attorney generals" would be limited to the corporation in which they are shareholders. It could not, with any logic, be extended in a derivative action to cover outside individuals, corporations, or institutions who are subject to other private and governmental restraints on their behavior. Furthermore, in affirming the dismissal of the *Diamond* complaint against other board members who were alleged to have aided the defendants in concealing their activities, the New York Court of Appeals made it quite clear that *Diamond* extends only to corporate fiduciaries who actually profit by inside information and does not cover aiders and abettors and/or conspirators. In view of the fact that the New York Court of Appeals could not bring itself to find liability for inter-corporate conspirators, I fail to perceive how this court could extend *Diamond* to cover extra-corporate conspirators and tippees. Accordingly, I conclude that with regard to all defendants save Chasen, the complaints herein fail to state a claim for which relief can be granted.

On the other hand, Chasen, as a corporate officer, might well come within the *Diamond* holding. Although it could be plausibly argued that *Diamond* would not apply to Chasen because of the failure to allege that he sold any stock and profited thereby, it might also be maintained that a New York court could find liability in light of the numerous statements in *Diamond* to the effect that the purpose of the holding is to prevent corporate misfeasance. This question, however, need not be reached because service of process upon Chasen was improper.

In diversity actions, this court's jurisdiction is determined by the law of the State of New York. Rule 4(d)(7), F.R.Civ.P. Because Chasen is not a New York resident and was not served in New York, jurisdiction of his person depends on the New York long-arm statute, CPLR

§ 302(a). It is plaintiffs' assertion that jurisdiction was obtained over Chasen because he set in motion events which culminated with the alleged sale of 83,000 shares of Lum's stock over an exchange located in New York. While I am aware that the scope of CPLR § 302(a) has been broadly construed, I fail to see how it can be read to cover the facts in this case.

While it is settled that one can "transact business" within the meaning of CPLR § 302(a) (1) through an agent, *Parke-Bernet Galleries, Inc.* v. *Franklyn,* 26 N.Y.2d 13, 308 N.Y.S.2d 337, 256 N.E.2d 506 (1970), a New York court would decline jurisdiction of a defendant who merely telephones a single order from outside the state. *Katz & Son Billiard Prods.* v. *Correale & Sons,* 20 N.Y.2d 903, 285 N.Y.S.2d 871, 232 N.E.2d 864 (1967). It seems obvious that Chasen, who did not place the order to sell the Lum's stock in question, did not "purposefully" avail himself "of the privilege of conducting activities" within New York, thereby "invoking the benefits and protections of its laws." *Hanson* v. *Denckla,* 357 U.S. 235, 253, 78 S.Ct. 1228, 1240, 2 L.Ed.2d 1283 (1958).

Plaintiffs next argue that the sale of stock over a national exchange in New York was a "tortious act within the state" and that jurisdiction could be found under CPLR § 302(a) (2). While such a sale will confer jurisdiction in some cases, *Cooper* v. *North Jersey Trust Co. of Ridgewood, New Jersey,* 250 F.Supp. 237 (S.D.N.Y., 1965), CPLR § 302(a) (2) can apply only where the non-resident defendant committed the tort in New York. That the alleged tort here may have been completed or "came to rest" in New York will not confer jurisdiction unless the acts or omissions complained of also occurred in New York. *Feathers* v. *McLucas,* 15 N.Y.2d 443, 261 N.Y.S.2d 8, 209 N.E.2d 68 (1965). *Cooper* v. *North Jersey Trust Co. etc.,*

supra, is not inconsistent as the defendants in that case were physically in New York when they allegedly committed the tort there in issue. As it is nowhere alleged that Chasen committed a tortious act in New York, no jurisdiction of his person can be claimed under CPLR § 302(a) (2).

Finally, there can be no jurisdiction under CPLR § 302(a) (3). As the statute clearly states, the tortious act must cause injury to persons or property in New York. Insofar as none of the non-resident plaintiffs in these cases have alleged that any injury occurred in New York, their invocation of this provision is futile.

Defendant Chasen's motion to dismiss is granted on the ground that no jurisdiction was ever obtained of his person. Rule 12(b) (2) F.R.Civ.P. The motions of the remaining defendants to dismiss under Rule 12(b) (6) F.R.Civ.P. are hereby granted. In view of these rulings, defendants' alternative motion for a stay of these actions need not be reached.

Settle orders accordingly.

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

70 Civil 5733 HRT

JOSEPH GILDENHORN, as Custodian for CAROL ANN GILDENHORN,

Plaintiff,

against

LUM'S INC., *et al.,*

Defendants.

71 Civil 1925 HRT

ANTONE F. GREGORIO,

Plaintiff,

against

LUM'S, INC., *et al.,*

Defendants.

71 Civil 4218 HRT

JACOB SCHEIN and MARVIN H. SCHEIN,

Plaintiff,

against

MELVIN CHASEN, *et al.,*

Defendants.

Defendants Investors Diversified Services, Inc., IDS New Dimensions Fund, Inc., and Investors Variable Payment

Fund, Inc., having moved to dismiss the complaints and the amended complaint in the above entitled actions under Rule 12(b) of the Federal Rules of Civil Procedure and the defendants Benjamin Simon, Lehman Brothers, Lum's, Inc., and Melvin Chasen having joined in said motion and said motions having come on to be heard before the Honorable Harold R. Tyler, United States District Judge, on November 19, 1971, and the Court having considered the papers submitted on said motions, having heard argument of counsel, and having issued an Opinion dated December 15, 1971 granting said motions, it is hereby

ORDERED that the above entitled actions be and they hereby are dismissed with prejudice, and without costs.

Dated: New York, New York
January 5, 1972

H. R. TYLER, JR.
U.S.D.J.

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 81 and 82—September Term, 1972.

(Argued October 17, 1972 Decided May 10, 1973)

Docket Nos. 72-1373, 72-1375

JACOB SCHEIN and MARVIN H. SCHEIN,

Plaintiffs-Appellants,

v.

MELVIN CHASEN, INVESTORS DIVERSIFIED SERVICES, INC., LEHMAN BROTHERS, INVESTORS VARIABLE PAYMENT FUND, INC., BENJAMIN SIMON, IDS NEW DIMENSIONS FUND, INC., EUGENE S. SIT, JAMES R. JUNDT, and LUM'S, INC.,

Defendants-Appellees.

ANTONE F. GREGORIO, individually and as representative of all persons similarly situated as a class under Rule 23, F.R.C.P.,

Plaintiff-Appellant,

v.

LUM'S, INC., MELVIN CHASEN, LEHMAN BROTHERS, BENJAMIN SIMON, INVESTORS DIVERSIFIED SERVICES, INC., EUGENE S. SIT, and JAMES R. JUNDT,

Defendants-Appellees.

Before:

WATERMAN, SMITH and KAUFMAN,

Circuit Judges.

Invoking the diversity jurisdiction of the court, plaintiffs in three cases consolidated below sued derivatively in United States District Court for the Southern District of New York, Tyler, *J.*, alleging that defendants were jointly and severally liable under state corporation law for the profits realized by the defendants Mutual Funds through their trading on the New York Stock Exchange in derivative defendant's stock on the basis of non-public material inside information. An order granting summary judgment was granted to defendants and in two of the consolidated actions the parties have argued appeals.

Reversed and remanded for further proceedings consistent with this opinion.

WATERMAN, *Circuit Judge:*

Plaintiffs-appellants are stockholders in Lum's, Inc., a Florida corporation primarily engaged in restaurant franchising. Invoking the diversity jurisdiction of the court, they sued derivatively in the Southern District of New York alleging that the defendants were jointly and severally liable to Lum's for actionable wrongs which the defendants had committed against Lum's. The individual defendants were Melvin Chasen, a resident of Florida, president of Lum's, Benjamin Simon, a stockbroker employed in Chicago, Ill. by defendant Lehman Brothers, Eugene S. Sit, portfolio manager of defendant IDS New Dimensions Fund, Inc., a Mutual Fund, and James R. Jundt, manager of defendant Investors Variable Payment Fund., Inc., a Mutual Fund. Each of the four individual defendants moved for dismissal on the ground that they had not been validly served under the New York Long Arm Statute (CPLR §§ 313, 302(a)) and that the court below had no personal jurisdiction of them. Sit's and Jundt's motions were granted prior to the filing of the

order appealed from, Chasen's was granted concurrently therewith, and Simon's has apparently not been acted upon.[1] The defendants Lehman Brothers, a partnership engaged in stock brokerage and investment counseling, the three corporations, engaged in managing investment portfolios and in buying and selling the corporate securities of publicly held corporations, Chasen, and Simon, all moved for dismissal on the ground that the complaints failed to state a cause of action under Florida law. Plaintiffs claimed that New York law should govern the rights and liabilities of the parties, and that even if Florida law were the applicable law they should still prevail. Holding that Florida law was the proper state law to apply, Judge Harold R. Tyler, Jr., by written order, *sub nom Gildenhorn* v. *Lum's, Inc.,* opinion reported at 335 F.Supp. 329 (SDNY 1971), granted the motion to dismiss for failure to state a claim upon which relief could be granted.

On this appeal plaintiffs claim only that Judge Tyler erred in dismissing the complaints for failure to state a cause of action.[2] They do not appeal Judge Tyler's order dismissing Chasen as a defendant or his finding that the substantive law of Florida governs the action.[3] Inasmuch

[1] Plaintiffs-appellants have not appealed the order dismissing the actions against Chasen, Sit and Jundt. Simon filed a similar dismissal motion but the trial court did not decide it. Simon was dismissed as a defendant by the court's order dismissing the complaints against all defendants for failure to state a cause of action under 12(b)(6) of the Fed. R. Civ. P. Simon contends on this appeal that irrespective of our action on the lower court's dismissal of the complaints under 12(b)(6), we should dismiss the action against him because he has not been validly served. However, inasmuch as the trial court has not reached this question, we decline to address it on this appeal, and leave its resolution to the trial court upon remand.

[2] In one of the original actions consolidated below, *Gildenhorn* v. *Lum's, Inc.,* 335 F.Supp. 329 (SDNY 1971) a notice of appeal was filed by plaintiff but the parties have not progressed the appeal.

[3] The parties now agree that the substantive law of the State of Florida governs the action for reasons which are stated in Judge Tyler's opinion reported at 335 F.Supp. 329 (SDNY 1971).

as the court is passing only upon the sufficiency of the complaints, we necessarily accept the allegations of the complaints as true. For reasons which follow, we hold that the complaints do state a cause of action and we reverse the judgment below and remand to the district court for further proceedings there in the light of this holding.

The facts alleged in this case fall within the perimeter of the much-discussed problem of unfair trading in corporate securities. In November of 1969 Chasen, who was president and chief operating officer of Lum's addressed a seminar of about sixty members of the securities industry with reference to Lum's earnings prospects for its fiscal year ending July 31, 1970. He informed them that Lum's earnings would be approximately $1.00 to $1.10 per share. On January 5, 1970 he learned that this estimate was too optimistic and that, in fact, Lum's earnings would be only approximately $.76 per share. Three days later, prior to announcing the information to the public, Chasen telephoned Simon in Chicago and told Simon that Lum's would not have as profitable a year as had been expected. He specified to Simon that earnings would be approximately $.76 per share rather than the $1.00 per share which he had earlier announced. Simon knew the information was confidential corporate property which Chasen had not given out publicly. Simon immediately telephoned this information to Sit, an employee of defendant Investors Diversified Services, Inc. (IDS),[4] and Sit immediately telephoned it to Jundt, another employee of IDS. Sit and Jundt managed the stock portfolios of defendant mutual funds Investors Variable Payment Fund, Inc. (Investors) and IDS New Dimensions Fund, Inc. (Dimensions). Upon receiving the

[4] Defendant IDS is a Minnesota corporation licensed to do business in the State of New York. IDS is the distributor and investment advisor for a number of large mutual funds including defendants Investors and Dimensions. Sit and Jundt are employed by IDS to manage the stock portfolios of Investors and Dimensions.

information Sit and Jundt directed the Funds to sell their entire stock holdings in Lum's and, on the morning of January 9, 1970, prior to any public announcement, Investors sold 43,000 shares of Lum's and Dimensions sold 40,000 shares. The sales were executed on the New York Stock Exchange at about 10:30 A.M. at a price of approximately $17.50 per share. At 1:30 P.M. on the same day, the New York Stock Exchange halted further trading in Lum's stock pending a company announcement. At 2:45 P.M. Lum's issued a release which appeared on the Dow Jones News Wire Service and announced that the corporation's projected earnings would be lower than had been anticipated. When trading in Lum's was resumed on Monday, January 12, 1970, volume was heavy and the stock closed at a price of $14.00 per share—$3.50 per share lower than the Funds had realized from the sales of their shares on the previous Friday.

The present defendants in this case are Lehman Brothers, Simon, and the two Mutual Funds. Chasen, Sit, and Jundt have been dismissed as defendants in that they have not been validly served under the New York State Long Arm Statute. Plaintiffs-appellants' theory of recovery is that the participants in this chain of wrongdoing are jointly and severally liable to the corporation under Florida law for misusing corporate information to their own advantage in violation of the duty they owed to Lum's, and that they must account to Lum's for the profits realized by the Mutual Funds. They do not allege in these complaints that defendants have violated any of the federal securities laws,[5] and they concede that the substantive law

[5] Lum's could apparently not prevail as a plaintiff in a Rule 10b-5 action in that it has not traded in its securities on its own account. See *Birnbaum* v. *Newport Steel Corporation*, 193 F.2d 461 (2 Cir. 1952), cert. denied, 343 U.S. 956 (1952). Although there are federal securities law cases pending against defendants in district court, this fact is irrelevant upon this appeal.

of Florida governs the rights and liabilities of the parties. They urge, however, that inasmuch as there are no Florida cases directly in point, the Florida court, if it were deciding the case, would look to other jurisdictions and would take a particular and special interest in the decision of *Diamond* v. *Oreamuno,* 29 A.D.2d 285, 287 N.Y.S.2d 300 (1st Dep't 1968), *aff'd* 24 N.Y.2d 494, 301 N.Y.S.2d 78 (1969), a case which plaintiffs contend supports the position they urge on this appeal.

The first question which our court must consider is whether we may look to the New York decision of *Diamond, supra,* as persuasive authority. Ideally, the federal court sitting in a diversity action applies the applicable state law as it has been enunciated by the highest court in the state. *Erie R. Co.* v. *Tompkins,* 304 U.S. 64 (1938); *Hausman* v. *Buckley,* 299 F.2d 696 (2 Cir. 1962), *cert. denied,* 369 U.S. 885 (1962). However, in the absence of a clearly enunciated state rule, the federal court may turn to the law of other jurisdictions for assistance in determining how the state court would most likely decide the case if the state court were presented with the questions being litigated in the federal court. *Baxter* v. *Lancer Industries, Inc.,* 213 F.Supp. 92 (EDNY 1963), *app. denied,* 324 F.2d 286 (2 Cir. 1963); *Locke Manufacturing Companies* v. *United States,* 237 F.Supp. 80 (D. Conn. 1964). Our foray into the state law of Florida satisfies us that the Florida court has never faced the precise issues which are present in this action. Accordingly, it is both proper and practical for this court to turn for guidance to the body of law of other jurisdictions and particularly to that of New York where the resolution of the issues in the *Diamond* case, decided by the New York Court of Appeals, bears on the issues in the case before us. In doing so, our objective is to interpret *Diamond* as the Florida court would probably interpret it and

to apply *Diamond,* as so interpreted, to the facts presented here.

Diamond v. *Oreamuno, supra,* was a stockholder's derivative action in which a shareholder of Management Assistance, Inc. (MAI) charged that two of the defendants—Oreamuno, chairman of the board of directors, and Gonzales, its president and a member of the board, had used inside information acquired by them solely by virtue of their positions with MAI in order to reap large personal profits from the sale of MAI shares, and that these profits rightfully belonged to the corporation. Chief Judge Stanley Fuld, writing for a unanimous court, held that the two directors must account to the corporation for their profits for they had breached their duty to the corporation by using a corporate asset for their own personal advantage.

In this case we are asked to decide whether the *Diamond* holding should extend to reach third parties who, though not officers or directors of the injured corporation, are involved with directors in a common enterprise to misuse confidential corporate information for their own enrichment. Although there is no allegation in the complaints that a prior explicit agreement existed between Chasen and the defendants, it is obvious that the sequence of events detailed in the pleadings, if proved, will substantiate the existence of a common enterprise pursuant to which Chasen was to pass material information to Simon, Simon was to pass it to the Mutual Funds, and the Funds were to capitalize on it by selling Lum's stock prior to the time the material information was announced to and was available to the public. Cf. *American Tobacco Co.* v. *United States,* 328 U.S. 781 (1946); *Interstate Circuit, Inc.* v. *United States,* 306 U.S. 208 (1939); *Norfolk Monument Company* v. *Woodlawn Memorial Gardens, Inc.,* 394 U.S. 700 (1969). Although defendants do not deny that they have been involved in a joint enterprise with Chasen to misuse corpo-

rate property, they argue that the doctrine of *Diamond* is not applicable here and that they cannot be held liable to Lum's because they are not Lum's fiduciaries and have not breached any duty which they owed to Lum's by cashing in on confidential information for their own advantage. Defendants Simon and Lehman Brothers make the further argument that it would be "unfair" to hold them responsible for the profits made by the Mutual Funds in that they (Simon and Lehman Brothers) did not profit personally inasmuch as neither of them traded in Lum's stock.

As a court of equity viewing the case as the Florida court would probably view it, we cannot agree that the "stretch" of *Diamond* does not reach the defendants in this case. We find nothing in the language of *Diamond* to suggest that co-venturers of the director who breaches his duty should not be subject to the same liabilities as those of the director himself for the misuse of corporate information.[6] Indeed, the general rule has always been that "one who knowingly participates in or joins in an enterprise whereby a violation of a fiduciary obligation is effected is liable jointly and severally with the recreant fiduciary." *Oil & Gas Ventures—First 1958 Fund Ltd.* v. *Kung,* 250 F.Supp. 744 (1966); see, *e.g., Jackson* v. *Smith,* 254 U.S. 586, 589 (1921); *Sexton* v. *Sword S.S. Line Inc.,* 118 F.2d 708, 711 (2 Cir. 1941); *Bankers Life and Casualty Co.* v. *Kirtley,* 338 F.2d 1006, 1013 (8 Cir. 1964). If the *Diamond* court had intended to lay down an exception to this well-

[6] We believe Judge Tyler erred in attaching dispositive significance to the fact that in *Diamond,* supra, the complaint was dismissed against certain directors who had only "acquiesced" in the wrong. The defendants-appellees here differ from the dismissed *Diamond* defendants in that the defendants-appellees were actively engaged in furthering the transaction that resulted in the "dumping" of the Lum's stock, rather than just "acquiescing" in it. Furthermore, and even more importantly, *Diamond* was not a "joint venture" case, and there is no discussion in the *Diamond* opinion as to why the complaint was dismissed against the "acquiescing" directors.

known general rule it could have done so in its opinion. Moreover, in the light of the corporate interest which the *Diamond* rule is designed to protect, it is immaterial to the preservation of that interest whether the director trades on his own account in the corporation's stock or whether he passes on the information to outsiders who then trade in the corporation's stock. In either event, so long as the director is involved, the prestige and good will of the corporation may be tarnished by the public revelation that the director has been involved in unethical conduct. *Diamond, supra* at 499; accord, *S.E.C.* v. *Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1308 (2 Cir. 1971), *cert. denied*, 404 U.S. 1005, *reh. denied*, 404 U.S. 1064 (1972). Accordingly, it would be self-defeating to limit the reach of *Diamond* to directors and officers of the injured corporation who have so acted while permitting third-party co-venturers of theirs to escape liability to the corporation.

Diamond, the law of the jurisdiction in which the New York Stock Exchange is seated, has the prophylactic effect of providing a disincentive to insider trading. It is clear that this cleansing effect ought to reach third parties who, through a breach of a fiduciary relationship, become traders advantageously possessed of confidental insider knowledge. To immunize such third parties from liability to the damaged corporation would encourage insider "leaks" to outside friends and would defeat *Diamond's* purpose and effect. And, quite properly, damages for fiduciary breaches are recoverable by recourse to state law. Indeed, though the congressional policy is similar, in some cases where federal private and governmental Rule 10b-5 actions are impractical, "immunized outsiders" might escape liability altogether except for the availability of this kind of action bottomed upon the well-recognized liability of a fiduciary to those whose trust in the fiduciary has been tragically

misplaced. In view of the strong desirability of tightening the law of insider trading, we would be remiss indeed if we interpreted *Diamond* as narrowly as defendants would have us interpret it. Moreover, sitting as a court of equity, we have here an obligation to determine where the equities lie among all the litigants, *Diamond, supra* at 498, and, as between the defendants and Lum's, there can be no doubt that it would be inequitable to permit the defendants to keep the rewards of the fraud.[7]

Our view that all the participants in the common enterprise must assume the same risks of liability to the corporation as the offending director is supported by Florida case law dealing with the duty of a fiduciary to his cestui. The Florida courts have held that the duty of a fiduciary not to misuse the property of his cestui extends not only to the "technical fiduciary" but also to others who are placed in a position of trust. *Quinn* v. *Phipps*, 93 Fla. 805, 113 So. 419 (1927). The confidential relationship of a fiduciary as that relationship is spelled out in Florida law extends not only to "technical fiduciaries" but also to others who become "fiduciaries" through the acquisition of confidential information which is "owned" by someone else. See *Quinn* v. *Phipps, supra* at 420-421. When the defendants received their "tip" from Chasen, they were automatically clothed with a duty to Lum's not to use the information for their own selfish advantages. Compare *Brophy* v. *Cities Service Co.*, 31 Del. Ch. 241, 70 A.2d 5 (1949); *Ohio Oil Co.* v. *Sharp*, 135 F.2d 303 (10 Cir. 1943).

[7] This principle has been applied in analogous cases involving violations of the federal securities laws. In more than one instance, the corporation whose stock has been illegally traded has been permitted to recover conditionally in a Rule 10b-5 action because it is more equitable for it to recoup the rewards of the fraud than for the insider who profits by misusing corporate information to keep them. See *Securities and Exchange Commission* v. *Texas Gulf Sulphur*, 446 F.2d at 1308; *S.E.C.* v. *Golconda Mining Company*, 327 F.Supp. 257 (SDNY 1971).

This is firmly grounded in law and the rule is set forth in the American Law Institute's Restatement of Agency 2d § 312 (1958): "A person who, without being privileged to do so, intentionally causes or assists an agent to violate a duty to his principal is subject to liability to the principal." And see Comment c to § 312:

> A person who, with notice that an agent is thereby violating his duty to his principal, receives confidential information from the agent, may be enjoined from disclosing it and required to hold profits received by its use as a constructive trustee. * * * *

Therefore, if plaintiffs can prove their allegations, it would seem that liability of the Mutual Funds to Lum's must necessarily follow. Be that as it may be, however, the defendants Lehman Brothers and Simon contend that it would be inequitable to apply the rule to them because they did not personally profit by trading in Lum's stock and they hold no profits as constructive trustees of that corporation. Nevertheless, Lehman Brothers and Simon obviously misused inside information as much as Diversified and Investors misused it, and therefore we fail to see how equity would be furthered by imposing liability only on the Funds and not on the other participants who supplied the Funds with the inside information. It is well established that the liabilities of persons engaged in a joint enterprise to commit a wrong are both joint and several liabilities and each participant is liable to account for the profits of the other participants. *Marcus* v. *Otis,* 168 F.2d 649 (2 Cir. 1948), *modified,* 169 F.2d 148 (2 Cir. 1948); *Solomon* v. *United States,* 276 F.2d 669 (6 Cir. 1960), *cert. denied,* 364 U.S. 890 (1960), *reh. denied,* 364 U.S. 939 (1961). Accordingly, we hold that it would be proper to hold Lehman Brothers and Simon just as accountable for

the profits made by their tippees Diversified and Investors as the tippees themselves.[8]

Defendants also contend that the complaints are presently insufficient because they fail to allege with sufficient particularity the damages Lum's is claimed to have suffered. This contention is without merit. Although the Gregorio complaint fails to allege any damages to Lum's, the Schein complaint contains a general allegation of damages, and we find nothing in Florida law to require anything more than a general ad damnum allegation.[9]

Defendants also urge that inasmuch as there are private Rule 10b-5 class actions for damages, *e.g., Sanders* v. *Lum's, Inc., et al.,* 70 Civ. 5331 (SDNY) and an administratve suit brought by the Securities and Exchange Commission, *SEC* v. *Lum's, et al.,* 70 Civ. 5280 (SDNY), pending in federal district court, defendants might be subjected to multiple liability if they are forced to remit to Lum's the profits the Mutual Funds made on their January 9 sales. Since appel-

[8] In passing we note decisions dealing with violations of the federal securities laws which involve the imposition of liability on defendants who have occupied statuses similar to the statuses occupied by defendants in this case. Thus, in *Securities and Exchange Commission* v. *Texas Gulf Sulphur,* 446 F.2d at 1308, the same argument raised by Simon and by Lehman Brothers was raised by defendant Darke. This court held that Darke was liable as a tippor for the profits realized by his tippees. Furthermore, "tippee liability," which is analogous to the liability being imposed upon Diversified and Investors, has been established in federal cases involving violations of the securities laws. See *Ross* v. *Licht,* 263 F.Supp. 395 (SDNY 1967); *In the Matter of Cady, Roberts & Co.,* 40 S.E.C. 907 (1961).

[9] We find it unnecessary to decide whether the defendants could prevail if ***neither*** complaint alleged damages to Lum's. We point out, however, that Florida law is not clear on the question and *Diamond* holds specifically that an allegation of damages is not a prerequisite to a recovery. *Diamond* v. *Oreamuno, supra* at 499. The case cited by defendants for the proposition that damages must be alleged (*Palma* v. *Zerbey,* 189 So.2d 510 (Fla.App. 1966), cert. denied, 200 So.2d 814 (Fla. 1967)) is a one paragraph per curiam opinion of a lower Florida court, the Florida District Court of Appeals which, inasmuch as it fails to provide a discussion of the issues, we find to be totally unpersuasive.

lees are fully aware of these federal court actions they are well able to protect themselves from multiple liability.[10]

Preventing those who are privy to confidential inside information from using it to their own advantage has found expression in numerous cases in the federal courts dealing with violations of the federal securities laws. See *Securities and Exchange Commission* v. *Texas Gulf Sulphur,* 401 F.2d 833 (2 Cir. 1968), *cert. denied sub nom. Coates* v. *SEC,* 394 U.S. 976 (1969); *List* v. *Fashion Park, Inc.,* 340 F.2d 457 (2 Cir. 1965), *cert. denied,* 382 U.S. 811 (1965); *Wohl* v. *Blair & Co.,* 50 F.R.D. 89 (SDNY 1970); *Ross* v. *Licht,* 263 F.Supp. 395 (SDNY 1967); *Speed* v. *Transamerica Corp.,* 99 F.Supp. 808, 828-829 (D.Del. 1951), *aff'd* 235 F.2d 369 (3 Cir. 1956).

Accordingly, as to those persons found to be within the jurisdiction of the court, we reverse the order appealed from and remand the case for such further proceedings below as may be consistent with the contents of this opinion.

KAUFMAN, *Circuit Judge* (dissenting):

In my view, it is no longer debatable that trading on inside information merits universal condemnation.[1] The undesirable nature of "insider trading" is reflected in the prophylactic provisions of Section 16(b) of the Securities Exchange Act of 1934 and the more general antifraud principles of Section 10b of that Act. I fully agree with Judges Waterman and Smith that one with access to material inside information concerning a corporation's affairs who

[10] See, for example, the method employed in *Securities and Exchange Commission* v. *Texas Gulf Sulphur Co.,* 312 F.Supp. 77, 93 (SDNY 1970), *aff'd in part, rev'd in part,* 446 F.2d 1301 (2 Cir. 1971), cert. denied, 404 U.S. 1005 (1971), reh. denied, 404 U.S. 1064 (1971).

[1] But for a contrary view, *see* H. Manne, Insider Trading and the Stock Market (1966).

knowingly purchases or sells that corporation's shares before this information has become publicly available takes unfair advantage of unknowledgeable parties to the transaction. Indeed, the factual claims contained in the complaints before us have led to two federal actions—an SEC injunctive action and a private class action under rule 10b-5—now pending in the District Court for the Southern District of New York. But the adage that hard facts make bad law is about to come true here, despite Judge, later Justice, Cardozo's warning that judges are not free agents roaming at will to create law to fit the facts. *See* The Nature of the Judicial Process 141 (1921). In the absence of any viable precedent upon which to base the totally new concept of law espoused by my brothers, it is clear that they announce an extraordinary, expansive, and incorrect reading of New York law solely because of their urge to "provid[e] a disincentive to insider trading." I agree with their objective but I question the means employed.

The court holds today that a person with no relationship whatsoever—fiduciary or otherwise—to a corporation, who trades its shares on the basis of material inside information becomes, *ipso facto,* a fiduciary of the corporation whose shares he traded and, accordingly, may be required in a *shareholders' derivative action*—not a Section 10(b) or 16(b) action—to pay his profits to the corporation. With all due respect to my brothers, the tortured reasoning to which they are compelled to resort in reaching this conclusion represents a distortion of the law of agency and the law of fiduciary responsibility in which I am unable to join. Accordingly, I dissent.

Stripped of excess verbiage, the complaints in the two consolidated stockholders' derivative actions before us make the following allegations. In January, 1970, Melvin Chasen, president of Lum's, learned that an earnings estimate of between $1.00 and $1.10 per share previously released to the

financial community was grossly inaccurate. A more realistic figure was $.76 per share. Chasen revealed this information on January 8, during a telephone conversation, to Benjamin Simon, an employee in Lehman Brothers Chicago office. Simon, in turn, disclosed the adverse news to Eugene Sit, portfolio manager of Investors Variable Payment Fund, Inc., who himself conveyed the information to James Jundt, portfolio manager of IDS New Dimensions Fund, Inc. Both Sit and Jundt are employees of Investors Diversified Services, Inc. (IDS), investment adviser to the two mutual funds. During the morning of Friday, January 9, prior to any public disclosure of the reduced earnings figure, the two mutual funds sold a total of 83,000 shares of Lum's stock on the New York Stock Exchange at a price of approximately $17.50 per share. Later that day, after the Exchange halted trading in Lum's shares, Lum's publicly announced the reduced earnings forecast. Trading did not resume until the following Monday, when the closing price fell to $14.00 per share.

It is important to note at the outset that the plaintiffs in these actions, shareholders of Lum's, do not claim to have suffered any damages themselves. Rather, these derivative suits are brought "on behalf of and for the benefit of Lum's." They seek to recover for Lum's treasury the windfall profit garnered by the IDS mutual funds, and assert that all defendants are jointly and severally liable for this amount. Thus, the proper method of analysis is not to focus on the unfairness of the mutual funds' profit at the expense of their purchasers—who have their own recourse for any wrongdoing—but on the strands of duty running to the corporation from the various individuals involved. The crux of the majority's holding is that the institutional defendants—Lehman Brothers, IDS, and the two mutual funds—and their employees—Simon, Sit, and

Jundt—are within the sweep of fiduciary principles announced in *Diamond* v. *Oreamuno,* 24 N.Y.2d 494, 301 N.Y.S.2d 78 (1969). But a careful examination of that case and the principles underlying it demonstrate that *Diamond* is wholly inapposite to this case.

In *Diamond,* the New York Court of Appeals dealt with a derivative action brought by a shareholder of Management Assistance, Inc. (MAI) against Oreamuno, chairman of the board of directors of the corporation, and Gonzalez, its president. The complaint charged that by virtue of their corporate positions, these officers knew that a supplier's price increase had caused MAI's earnings to decrease by more than 75% during a one month period. According to the allegations, the two officers sold over 50,000 MAI shares at a price of $28 per share prior to public disclosure of the adverse earnings figures, after which the price per share plummeted to $11. In reviewing the Appellate Division's refusal to order dismissal of the complaint against Oreamuno and Gonzalez, Chief Judge Fuld stated at the outset that "the question presented—one of first impression in this court—is whether *officers and directors* may be held accountable to their corporation for gains realized by them from transactions in the company's stock as a result of their use of material inside information," 24 N.Y.2d at 496, 301 N.Y.S.2d at 79 (emphasis added). A careful reading of the *Diamond* opinion reveals that Oreamuno's and Gonzalez's liability in a stockholders' derivative action was grounded solely in their having breached a fiduciary duty owed by them to MAI as corporate officials.

The inapplicability of these principles to any of the appellees[2] is readily apparent. The complaints here are

[2] As noted in the majority opinion, the only defendants remaining on appeal are Lehman Brothers, IDS, the two mutual funds, and Simon. The district court dismissed the actions against Chasen for lack of personal jurisdiction, a holding not challenged on appeal. Accordingly, this court need not comment on the nature and extent of Chasen's liability to Lum's because of his conduct.

barren of any allegation that the appellees—or Sit or Jundt —occupied any position, such as officer, director, employee, or agent, which would create fiduciary obligations to Lum's. *Compare Brophy* v. *Cities Service Co.*, 31 Del. Ch. 241, 70 A.2d 5 (1949); *Quinn* v. *Phipps*, 93 Fla. 805, 113 So. 419 (1927). Liability in *Diamond* was predicated entirely on such a relationship, and in its absence, the *Diamond* rationale for liability ceases to exist.

In an effort to bridge this fatal gap, the majority, without any basis in law or fact, reasons that the appellees were involved in a "joint" or "common enterprise" with Chasen, president of Lum's, "to misuse confidential corporate information for their own enrichment." By use of this interesting, but nevertheless fictional, theory, they seek to foist upon the appellees liability to Lum's for Chasen's improper behavior. But the facts alleged in the complaints are a far cry from the "conscious parallelism" cases, drawn from the antitrust field, cited as authority in the majority opinion; the facts simply do not comport with the concept of a joint enterprise, a term which implies the existence of a prior plan to carry out a mutually beneficial project. The complaints, read in the most favorable light to the plaintiffs, disclose nothing more than a seemingly unsolicited and haphazard revelation of certain information which was useful in making investment decisions. There are ample remedies under the federal securities laws to punish this conduct. But, I am unable to understand on what basis the majority transforms the appellees' spontaneous conduct into a nefarious, prearranged, and ongoing scheme so that "joint" or "common enterprise" principles can make them liable as fiduciaries of a corporation with which they have no relationship.

A primary authority upon which the majority relies, § 312 of the American Law Institute's Restatement of

Agency 2d, exposes the inappropriateness of holding the appellees liable to Lum's for their conduct. Section 312 provides that "A person who, without being privileged to do so, intentionally causes or assists an agent to violate a duty to his principal is subject to liability to the principal." Although Comment *c* to this section speaks generally of receipt of confidential information by a third person from a principal's agent, the central element of liability is the third party's active and intentional aiding in the agent's violation of a duty owed to his principal. In this case, Chasen's duty to Lum's was to not disclose confidential corporate information. Yet there is not a word in the complaint charging that the appellees actively solicited the disclosure or that they had concocted a prearranged scheme with Chasen.[3] We are dealing here with an isolated transaction.

In the absence of any coherent legal theory, I cannot join my brothers in approving the use of the shareholders' derivative action device merely because, as my brothers candidly admit, to do so possibly may have a deterrent effect on "insider trading." Although developments in federal securities law indicate an expanding scope of liability for tippee traders, *see In re* Investors Management Co., Securities and Exchange Commission Release No. 34-9267 (Jul. 29, 1971) (SEC sanctioning of institutional investors

3. It is of no small significance that in the *Diamond* litigation, the Appellate Division affirmed dismissal of the complaint against other MAI directors—fiduciaries to the corporation—who allegedly "approved, acquiesced in or ratified" Oreamuno's and Gonzalez's transactions. 29 A.D.2d 285, 287 N.Y.S.2d 300 (1968). Despite the majority's effort in a footnote to "distinguish" this disposition, I believe the Appellate Division's action is clearly dispositive of the point before us. If the New York courts would not impose liability upon a director—a fiduciary of the corporation—who took no affirmative steps to cause or assist in a breach of a fiduciary duty by the corporation's president, I fail to see by what logic it can be urged that New York courts would hold liable a non-fiduciary who did not cause or assist in the breach.

who sold a corporation's shares after the corporation's underwriter revealed adverse earnings results to them); *cf. SEC* v. *Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1308 (2d Cir. 1971), *cert. denied*, 404 U.S. 1005 (1972) (affirming district court order, in SEC injunctive suit, requiring a "tippor" to divest an amount equal to his tippees' profits), the impetus for developing this expanded federal law liability—whose exact nature and scope remain in a formative stage— is the need to maintain free and honest securities markets. This need appropriately is given great weight when we consider claims under the federal securities law. But it is inapposite in determining whether, *under state common law*, tippee trading is a breach of a fiduciary duty owed to the corporation whose shares are traded, and if so, whether such a breach is remediable through use of a shareholders' derivative action.

In these actions, where jurisdiction is grounded solely in diversity of citizenship, the parties and the majority agree that our duty is to apply the law of Florida. Yet because there are no pertinent Florida decisions, the majority focuses on a New York decision, *Diamond* v. *Oreamuno*, *supra*. Thus, liability is founded on the conclusion of two federal judges that the Florida Supreme Court, if the instant case was before it, would look to a New York decision and, in addition, would give an unprecedented expansive reading to that case.

Despite the manner in which the majority opinion convolutes the law and the facts in this case, a view that a tippee is cloaked with state law fiduciary obligations to the corporation whose shares he trades is an unknown and untenable legal concept. Neither *Diamond*—itself a significant alteration of the common law principles applicable to

an officer's or director's trading in his corporation's shares[4] —nor the law of agency support such a holding. Nothing in the majority opinion tells us why or on what grounds a New York court would hold a tippee trader liable to the corporation for his profits under common law fiduciary principles, and the court exceeds its authority by substituting its own view of what state law ought to be, for what the state law actually is.

Moreover, since the outcome of this case turns, ultimately, upon Florida law, I fail to comprehend why my brothers refuse to utilize Florida's certified question statute, Fla. Stat. Ann. §25.031.[5] This enlightened law provides for certification to the Florida Supreme Court by a federal appellate court of an unresolved question of Florida law which is determinative of a case before it and on which there are no clear, controlling Florida Supreme Court precedents. The statute states that the court, by

4. *See* Note, 1970 Wis. L. Rev. 576, 577. Although not dispositive, this fact augurs against assuming the state courts could make the broad holding so readily attributed to them by the majority.

5. The supreme court of this state may, by rule of court provide that, when it shall appear to the supreme court of the United States, to any circuit court of appeals of the United States, or to the court of appeals of the District of Columbia, that there are involved in any proceeding before it questions or propositions of the laws of this state, which are determinative of the said cause, and there are no clear controlling precedents in the decisions of the supreme court of this state, such federal appellate court may certify such questions or propositions of the laws of this state to the supreme court of this state for instructions concerning such questions or propositions of state law, which certificate the supreme court of this state, by written opinion, may answer.

This statutory authority has been implemented by Appellate Rule 4.61.

written opinion, then may answer the certified question. *See Aldrich* v. *Aldrich*, 375 U.S. 249 (1963); *Green* v. *American Tobacco Co.*, 304 F. 2d 170 (5th Cir. 1962). The uncertainty inherent in the majority's speculation over what the Florida courts would decide if faced with this novel question of tippee liability under state common law fiduciary principles in a stockholders' derivative action would be dispelled authoritatively and finally.

Accordingly, I respectfully dissent.

UNITED STATES COURT OF APPEALS

FOR THE

SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the tenth day of May, one thousand nine hundred and seventy-three.

Present—Hon. STERRY R. WATERMAN
Hon. J. JOSEPH SMITH
Hon. IRVING R. KAUFMAN, Circuit Judges.

72-1373—72-1375

JACOB SCHEIN and MARVIN H. SCHEIN,
Plaintiffs-Appellants,

v.

MELVIN CHASEN; INVESTORS DIVERSIFIED SERVICES, INC.; LEHMAN BROTHERS; INVESTORS VARIABLE PAYMENT FUND, INC.; BENJAMIN SIMON; IDS; NEW DIMENSIONS FUND, INC.; EUGENE C. SIT; JAMES R. JUNDT and LUM'S, INC.,
Defendants-Appellees.

ANTONE F. GREGORIO, individually and as representative of all persons similarly situated as a class under Rule 23 FRCP,
Plaintiff-Appellant,

v.

LUM'S INC., MELVIN CHASEN, LEHMAN BROTHERS, BENJAMIN SIMON, INVESTORS DIVERSIFIED SERVICES, INC., EUGENE C. SIT and JAMES R. JUNDT,
Defendants-Appellees.

Appeal from the United States District Court for the Southern district of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is reversed and that the action be and it hereby is remanded to said District Court for further precedings consistent with the opinion of this court with costs to be taxed against the appellees.

A. Daniel Fusaro
Clerk

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House in the City of New York, on the eighth day of June, one thousand nine hundred and seventy-three

JACOB SCHEIN and MARVIN H. SCHEIN,
Plaintiffs-Appellants,

v.

MELVIN CHASEN; INVESTORS DIVERSIFIED SERVICES, INC.; LEHMAN BROTHERS; INVESTORS VARIABLE PAYMENT FUND, INC.; BENJAMIN SIMON; IDS; NEW DIMENSIONS FUND, INC.; EUGENE S. SIT; JAMES R. JUNDT and LUM'S, INC.,
Defendants-Appellees.

ANTONE F. GREGORIO, individually and as representative of all persons similarly situated as a class under Rule 23 FRCP,
Plaintiff-Appellant,

v.

LUM'S INC., MELVIN CHASEN; LEHMAN BROTHERS; BENJAMIN SIMON; INVESTORS DIVERSIFIED SERVICES, INC.; EUGENE S. SIT and JAMES R. JUNDT,
Defendants-Appellees.

A petition for rehearing in banc having been filed herein by counsel for the Defendant-Appellee Benjamin Simon and no active circuit judge having requested that a vote be taken on said suggestion

Upon consideration thereof, it is

Ordered that said petition be and it hereby is denied.

A. DANIEL FUSARO
Clerk

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the eighth day of June, one thousand nine hundred and seventy-three

JACOB SCHEIN and MARVIN H. SCHEIN,
Plaintiffs-Appellants,

v.

MELVIN CHASEN; INVESTORS DIVERSIFIED SERVICES, INC.; LEHMAN BROTHERS; INVESTORS VARIABLE PAYMENT FUND, INC.; BENJAMIN SIMON; IDS; NEW DIMENSIONS FUND, INC.; EUGENE S. SIT; JAMES R. JUNDT and LUM'S, INC.,
Defendants-Appellees.

ANTONE F. GREGORIO, individually and as representative of all persons similarly situated as a class under Rule 23 FRCP,
Plaintiff-Appellant,

v.

LUM'S INC., MELVIN CHASEN, LEHMAN BROTHERS, BENJAMIN SIMON, INVESTORS DIVERSIFIED SERVICES, INC., EUGENE S. SIT and JAMES R. JUNDT,
Defendants-Appellees,

A petition for rehearing in banc having been filed herein by counsel for the appellee Lehman Brothers and no active circuit judge having requested that a vote be taken on said suggestion

Upon consideration thereof, it is

Ordered that said petition be and it hereby is denied.

A. DANIEL FUSARO
Clerk

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

Docket Nos. 72-1373, 72-1375

At a stated term of the United States Court of Appeals in and for the Second Circuit held at the United States Court House, in the City of New York on the eighteenth day of June, one thousand nine hundred and seventy-three.

Present: Hon. IRVING R. KAUFMAN
Hon. S. R. WATERMAN
Hon. J. JOSEPH SMITH, Circuit Judges.

JACOB SCHEIN and MARVIN H. SCHEIN,
Plaintiffs-Appellants,

v.

MELVIN CHASEN; INVESTORS DIVERSIFIED SERVICES, INC.; LEHMAN BROTHERS; INVESTORS VARIABLE PAYMENT FUND, INC.; BENJAMIN SIMON; IDS; NEW DIMENSIONS FUND, INC.; EUGENE S. SIT; JAMES R. JUNDT and LUM'S, INC.,
Defendants-Appellees.

ANTONE F. GREGORIO, individually and as representative of all persons similarly situated as a class under Rule 23 FRCP,
Plaintiff-Appellant,

v.

LUM'S, INC.; MELVIN CHASEN, LEHMAN BROTHERS; BENJAMIN SIMON; INVESTORS DIVERSIFIED SERVICES, INC.; EUGENE S. SIT; and JAMES R. JUNDT,
Defendants-Appellees.

A petition for a rehearing having been filed herein for counsel for the appellees Investors Diversified Services, Inc., Investors Variable Payment Fund, Inc., and IDS New Dimensions Fund, Inc.,

Upon consideration thereof, it is

Ordered that said petition be and it hereby is denied.

A. DANIEL FUSARO
Clerk

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

Docket Nos. 72-1373, 72-1375

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the eighteenth day of June, one thousand nine hundred and seventy-three,

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JACOB SCHEIN and MARVIN H. SCHEIN,
Plaintiffs-Appellants,

v.

MELVIN CHASEN; INVESTORS DIVERSIFIED SERVICES, INC.; LEHMAN BROTHERS; INVESTORS VARIABLE PAYMENT FUND, INC.; BENJAMIN SIMON; IDS; NEW DIMENSIONS FUND, INC.; EUGENE S. SIT; JAMES R. JUNDT and LUM'S, INC.,
Defendants-Appellees.

ANTONE F. GREGORIO, individually and as representative of all persons similarly situated as a class under Rule 23 FRCP,
Plaintiff-Appellant,

v.

LUM'S, INC.; MELVIN CHASEN, LEHMAN BROTHERS; BENJAMIN SIMON; INVESTORS DIVERSIFIED SERVICES, INC.; EUGENE S. SIT and JAMES R. JUNDT,
Defendants-Appellees.

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for the appellees Investors Diversified Services, Inc., Investors Variable Payment Fund, Inc., and IDS New Dimensions Fund, Inc., and no active circuit judge having requested that a vote be taken on said suggestion.

Upon consideration thereof, it is

Ordered that said petition be and it hereby is denied.

A. DANIEL FUSARO
Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM 1973

No. 73-439

LEHMAN BROTHERS, *Petitioner,*

v.

JACOB SCHEIN, MARVIN H. SCHEIN, ANTONE F. GREGORIO, *et al.* *Respondents.*

No. 73-440

BENJAMIN SIMON, *Petitioner, et al.,*

v.

JACOB SCHEIN and MARVIN H. SCHEIN, *Respondents.*

No. 73-495

INVESTORS DIVERSIFIED SERVICES, INC., INVESTORS VARIABLE PAYMENT FUND, INC. and IDS NEW DIMENSIONS FUND, INC., *Petitioners,*

v.

JACOB SCHEIN and MARVIN H. SCHEIN, *Respondents.*

INVESTORS DIVERSIFIED SERVICES, INC., *Petitioner,*

v.

ANTONE F. GREGORIO, *Respondent.*

BRIEF FOR RESPONDENTS IN OPPOSITION TO PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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October 12, 1973.

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IN THE

Supreme Court of the United States

OCTOBER TERM 1973

No. 73-439

LEHMAN BROTHERS,

Petitioner,

v.

JACOB SCHEIN, MARVIN H. SCHEIN, ANTONE F. GREGORIO, *et al.*,

Respondents.

No. 73-440

BENJAMIN SIMON,

Petitioner, et al.,

v.

JACOB SCHEIN and MARVIN H. SCHEIN,

Respondents.

No. 73-495

INVESTORS DIVERSIFIED SERVICES, INC., INVESTORS VARIABLE PAYMENT FUND, INC. and IDS NEW DIMENSIONS FUND, INC.,

Petitioners,

v.

JACOB SCHEIN and MARVIN H. SCHEIN,

Respondents.

INVESTORS DIVERSIFIED SERVICES, INC.,

Petitioner,

v.

ANTONE F. GREGORIO,

Respondent.

BRIEF FOR RESPONDENTS IN OPPOSITION TO PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Respondents respectfully submit this brief in opposition to the petitions for writs of certiorari to the United States Court of Appeals for the Second Circuit filed by the defendants in the actions entitled *Schein et al.* v. *Chasen et al.* and *Gregorio* v. *Lum's et al.* The cases were heard together in the District Court and the Court of Appeals. The petitions of defendants Benjamin Simon (No. 73-440) and Lehman Brothers (No. 73-439) were filed September 6, 1973. The petition of defendants I[illegible]rs Diversified Services, Inc., Investors Variable Pa[illegible]und, Inc., and IDS New Dimensions Fund, Inc. (No. 73-495) was filed September 17, 1973. Petitioners ask this Court to review the judgment and decision of the United States Court of Appeals for the Second Circuit, entered May 10, 1973, which reversed the dismissal of these actions by the District Court for the Southern District of New York.

Opinions Below

The opinion of the Court of Appeals is reported at 478 F.2d 817 (2nd Cir. 1973). The opinion of the District Court is reported at 335 F. Supp. 329 (S.D.N.Y. 1971).

Questions Presented

1. Did the Court of Appeals for the Second Circuit in this action based upon diversity jurisdiction commit reversible error in deciding the merits of this case involving an unsettled issue of Florida common law and in not certifying the question to the Florida Supreme Court pursuant to Florida's optional certification procedure where the merits were fully briefed and argued to the Court of Appeals and where none of the parties urged or even suggested that the question of Florida law should not be decided by the Court of Appeals but rather should be certified to the Florida Supreme Court?

2. Did the Court of Appeals for the Second Circuit commit reversible error in not abstaining from a decision on the merits in this case where the merits were fully briefed and argued to the Court and none of the parties requested either the District Court or the Court of Appeals to abstain from deciding the merits of this case?

3. Did the Court of Appeals violate the principles of *Erie R. Co.* v. *Tompkins* in deciding the issue of Florida law in this case?

Statement of the Case

These actions are stockholder derivative actions in which federal jurisdiction is based upon diversity of citizenship. The cases present no federal questions. They were brought on behalf of Lum's Inc. (now known as Caesar's World, Inc. but hereinafter referred to as "Lum's"), a Florida corporation, and arise out of the defendants' alleged misuse of confidential corporate information.

The complaints charge that in November 1969, Melvin Chasen, Chief Executive Officer of Lum's, publicly announced that Lum's would have earnings of between $1.00 and $1.10 per share for its fiscal year ending July 31, 1970. However, on or about January 5, 1970, by virtue of his position with Lum's, Chasen learned that his earlier projection of an earnings increase for the second quarter was in error and that Lum's earnings for the year would only be about 75 cents per share. On January 8, 1970, before he disclosed this information to the shareholders of Lum's or the public generally, Chasen, in breach of his fiduciary duties to Lum's and its shareholders, called Simon, an institutional stock salesman of Lehman Brothers, and divulged to him the confidential information concerning Lum's earnings. Chasen also informed Simon that the disappointing

earnings were caused by problems in Lum's restaurant division, lower franchise sales and disappointing results at Caesar's Palace, a Las Vegas hotel casino owned by Lum's. On that same day after the close of trading on the New York Stock Exchange, Simon called Sit, the portfolio manager of IDS New Dimensions Fund, Inc. ("Dimensions"), and relayed the information given him by Chasen, informing Sit of the confidential source of the information. Sit immediately made the confidential information and its source known to Jundt, a manager and analyst for Investors Variable Payment Fund, Inc. ("Investors"). Both Dimensions and Investors are mutual funds for which Investors Diversified Services, Inc. ("IDS") is the investment advisor and distributor.

Based upon the nature and importance of the confidential material information which they had received from Chasen by way of Simon, IDS, Sit and Jundt determined that Dimensions and Investors should immediately sell the 83,000 shares of Lum's owned by them.

The following morning, a Friday, when trading opened on the New York Stock Exchange, Dimensions sold 40,000 shares of Lum's and Investors sold 43,000 shares of Lum's on the Exchange at approximately $17.50 per share. Each thus disposed of its entire holdings in that stock while in possession of the aforesaid confidential information and with the knowledge that such information had not been disclosed to the public generally.

At approximately 1:30 p.m. on the same day, the New York Stock Exchange halted trading in Lum's shares in anticipation of a company announcement. The announcement was made at 2:45 p.m. and contained substantially the same information that Chasen had leaked on January 8. Trading in Lum's was delayed until Monday morning, January 12, and the opening price was down over three

and one-half points from the prices Dimensions and Investors received on January 9.

The complaints charge that by reason of the foregoing, the defendants participated in or aided and abetted the breach of a fiduciary duty to Lum's and that said defendants are jointly and severally liable to Lum's for all profits made by any of them as a result thereof.

Since federal jurisdiction in this case is based upon diversity of citizenship, the New York federal courts were required to decide the case as the New York State courts would have. *Erie R. Co.* v. *Tompkins,* 304 U.S. 64 (1938). Since Lum's is a Florida corporation, the federal courts, under the rule of *Klaxon* v. *Stentor Electric Mfg. Co.,* 313 U.S. 487 (1941), were required to look to New York's choice of law rules to determine which law would apply to the situation at hand. In this case Florida law governed.

The District Court (Tyler, J.), while recognizing that there were no Florida cases which had previously dealt with the specific issues in this case, concluded that the decision in *Diamond* v. *Oreamuno,* 24 N.Y. 2d 494, 248 N.E. 2d 910, 301 N.Y.S. 2d 78 (1969), was not applicable to the issues herein and granted defendants' motion to dismiss pursuant to FRCP 12(b)(6) for failure to state a claim upon which relief can be granted. (App. 31a)

The Court of Appeals for the Second Circuit reversed, holding that the complaints alleged a valid claim under applicable state law. In reaching its decision, the Court of Appeals clearly recognized that its function was to decide the case on the basis of Florida law. (App. 6a) The Court observed, however, that since the Florida courts had never faced the precise issues which were present in this action:

> "* * * it is both proper and practical for this court to turn for guidance to the body of law of other jurisdic-

tions and particularly to that of New York where the resolution of the issues in the *Diamond* case, decided by the New York Court of Appeals, bears on the issues in the case before us. In doing so, our objective is to interpret *Diamond* as the Florida court would probably interpret it and to apply *Diamond*, as so interpreted, to the facts presented here." (App. 7a)

The Court of Appeals then discussed *Diamond*, which specifically upheld the right of a corporation to recover profits realized by corporate officials who trade on the basis of confidential corporate information, and considered whether the rationale of *Diamond:*

"• • • should extend to reach third parties who, though not officers or directors of the injured corporation, are involved with directors in a common enterprise to misuse confidential corporate information for their own enrichment." (App. 8a)

The Court of Appeals concluded:

"As a court of equity viewing the case as the Florida court would probably view it, we cannot agree that the 'stretch' of *Diamond* does not reach the defendants in this case. We find nothing in the language of *Diamond* to suggest that co-venturers of the director who breaches his duty should not be subject to the same liabilities as those of the director himself for the misuse of corporate information." (App. 8a-9a)

In passing, the Court of Appeals observed that:

"• • • it would be self-defeating to limit the reach of *Diamond* to directors and officers of the injured corporation who have so acted while permitting third-party co-venturers of theirs to escape liability to the corporation.

> • • • To immunize such third parties from liability to the damaged corporation would encourage insider 'leaks' to outside friends and would defeat *Diamond's* purpose and effect." (App. 10a)

The Court of Appeals noted that its interpretation of *Diamond* and the application of the rationale of *Diamond* to the issues in the instant case were in accord with other authorities:

> "Indeed, the general rule has always been that 'one who knowingly participates in or joins in an enterprise whereby a violation of a fiduciary obligation is effected is liable jointly and severally with the recreant fiduciary.' *Oil & Gas Ventures—First 1958 Fund Ltd.* v. *Kung*, 250 F.Supp. 744 (1966); see, e.g., *Jackson* v. *Smith*, 254 U.S. 586, 589 (1921); *Sexton* v. *Sword S.S. Line Inc.*, 118 F.2d 708, 711 (2 Cir. 1941); *Bankers Life and Casualty Co.* v. *Kirtley*, 338 F.2d 1006, 1013 (8 Cir. 1964)." (App. 9a)

The Court of Appeals also noted that its conclusion that a valid claim was stated against the defendants in this case was supported by Florida case law dealing with the duty of a fiduciary to his *cestui:*

> "Our view that all the participants in the common enterprise must assume the same risks of liability to the corporation as the offending director is supported by Florida case law dealing with the duty of a fiduciary to his cestui. The Florida courts have held that the duty of a fiduciary not to misuse the property of his cestui extends not only to the 'technical fiduciary' but also to others who are placed in a position of trust. *Quinn* v. *Phipps*, 93 Fla. 805, 113 So. 419 (1927). The confidential relationship of a fiduciary as that relationship is spelled out in Florida law extends not only

to 'technical fiduciaries' but also to others who become 'fiduciaries' through the acquisition of confidential information which is 'owned' by someone else. See *Quinn* v. *Phipps, supra* at 420-421. When the defendants received their 'tip' from Chasen, they were automatically clothed with a duty to Lum's not to use the information for their own selfish advantages." (App. 11a)

Finally, the Court of Appeals rejected the arguments by Lehman Bros. and Simon that the complaints failed to state a valid claim against them because they had not personally profited by trading in Lum's stock and that they held no profits as constructive trustees of Lum's:

"• • •[•]Lehman Brothers and Simon obviously misused inside information as much as Diversified and Investors misused it, and therefore we fail to see how equity would be furthered by imposing liability only on the Funds and not on the other participants who supplied the Funds with the inside information. It is well established that the liabilities of persons engaged in a joint enterprise to commit a wrong are both joint and several liabilities and each participant is liable to account for the profits of the other participants. *Marcus* v. *Otis*, 168 F.2d 649 (2 Cir. 1948), *modified*, 169 F.2d 148 (2 Cir. 1948); *Solomon* v. *United States*, 276 F.2d 669 (6 Cir. 1960), *cert. denied*, 364 U.S. 890 (1960), *reh. denied*, 364 U.S. 939 (1961). Accordingly, we hold that it would be proper to hold Lehman Brothers and Simon just as accountable for the profits made by their tippees Diversified and Investors as the tippees themselves.[•]" (App. 12a)

Judge Kaufman dissented, disagreeing with the majority of the Court of Appeals in the interpretation of *Diamond*

[•] Footnote omitted.

and in the application of the rationale of *Diamond* to the facts in this case. While Judge Kaufman expressed the view that the complaints did not state a valid claim against the defendants, he cited no Florida cases (or any other cases) in support of his dissenting opinion. In the last paragraph of his dissent Judge Kaufman added that the Court should have certified the issue to the Supreme Court of Florida. (App. 21a)

The issues in this case were fully briefed and argued by the parties to the Court of Appeals, including the applicability of the *Diamond* case as persuasive authority. None of the parties urged or even suggested in any way that the issues in this case should not be decided by the Court of Appeals, but rather should be certified to the Supreme Court of Florida pursuant to the optional procedure set forth in F.S.A. §25.031 and the accompanying rules. Use of the certification procedure was suggested for the first time in Judge Kaufman's dissent. The petitioners, having received an adverse decision from the Court of Appeals, now claim that it was error for the Court of Appeals to have decided the merits of this case notwithstanding the fact that petitioners never suggested in any way that the Court of Appeals should not do so.

ARGUMENT

I

The Court of Appeals Did Not Commit Reversible Error in Deciding the Merits of This Case and in Not Certifying the Issue of Florida Common Law to the Florida Supreme Court Since the Merits Were Fully Briefed and Argued to the Court of Appeals and None of the Parties Urged or Even Suggested That the Issue of Florida Law Should Not Be Decided by the Court of Appeals But Rather Should Be Certified to the Florida Supreme Court.

The petitioners herein contend that the Court of Appeals for the Second Circuit committed reversible error in deciding the issue of Florida common law in this case instead of certifying the question to the Florida Supreme Court as permitted by F.S.A. §25.031 and the accompanying court rules. Despite the absence of any federal question in this litigation, petitioners urge that this Court consider whether the Court of Appeals for the Second Circuit committed reversible error because it did not utilize a discretionary state certification procedure notwithstanding the fact that the petitioners had fully briefed and argued the merits of the case to the Court of Appeals and had never requested the Court of Appeals to certify the question or even suggested the possibility to the Court. In short, petitioners, once confident of success and quite willing to have the Court of Appeals determine the applicable state law, have changed their view in the face of an adverse decision on the merits. Raising the Florida certification procedure for the first time in their petitions for certiorari, they now ask this Court to reverse the decision below and give them a second chance.

In support of this new-found view that the Court of Appeals in the instant case should have certified the question to the Florida Supreme Court, petitioners rely primarily upon several cases in which the Court of Appeals for the Fifth Circuit followed that option. Based upon these cases, petitioners assert that the failure of the Court of Appeals for the Second Circuit to certify the issues in the instant case creates a "conflict" between the Courts of Appeals for the Second and Fifth Circuits which should be resolved by this Court. It is readily apparent, however, that petitioners' contention is baseless and that there is no conflict of law between the Circuits which requires resolution by this Court.

The Florida certification procedure is clearly discretionary. *Trail Builders Supply Co.* v. *Reagan,* 409 F. 2d 1059, 1061 (5th Cir. 1969). While the Fifth Circuit has often chosen to use this optional procedure, it has also on several occasions decided not to use it and to determine unsettled issues of Florida law itself. See e.g. *Weitzner* v. *United States,* 309 F. 2d 45 (5th Cir. 1962) (Court construes homestead provisions of Florida's constitution); *Hamilton* v. *Maryland Casualty Co.,* 368 F. 2d 768 (5th Cir. 1966) (Purely local dispute as to the meaning of an insurance contract; the court declined to certify the question even though it admitted that the state court might have been better able to resolve the issue; in deciding the issue, the court looked to the case law of 12 states); see also *Motor Vehicle Casualty Co.* v. *Atlantic National Insurance Co.,* 374 F. 2d 601 (5th Cir. 1967); *Greer* v. *Associated Indemnity Corp.,* 371 F. 2d 28 (5th Cir. 1967); *Pacific Indemnity Co.* v. *Broward Co.,* 465 F. 2d 99 (5th Cir. 1972); *Habecker* v. *Young,* 474 F. 2d 1229 (5th Cir. 1973). Furthermore, the Fifth Circuit cases which have utilized this procedure have typically involved a consented stipulation

framing the question to be certified (e.g. *A. R. Moyer Inc.* v. *Graham*, 443 F.2d 434 (5th Cir. 1971)) in contrast to the instant case where petitioners argued the merits of the case to the Court of Appeals for the Second Circuit and never even suggested that the question should be certified to the Florida Supreme Court.

Thus, the fact that the Fifth Circuit sometimes uses the Florida certification procedure, and that the Court of Appeals for the Second Circuit did not certify the question in this case where none of the parties requested certification and where the issues did not involve an interpretation of Florida legislation or matters peculiar to local Florida law, but rather involved a determination of Florida common law (which because of a dearth of relevant Florida authority required a review of various out-of-state persuasive authorities including the *Diamond* case, a New York decision), hardly presents a conflict of law between the Circuits which requires resolution by this Court as petitioners erroneously contend.

Dresner v. *City of Tallahassee*, 375 U.S. 136 (1963), 378 U.S. 539 (1964) and *Aldrich* v. *Aldrich*, 375 U.S. 75 (1963), 378 U.S. 540 (1964), also cited by petitioners, provide no support for their position. *Dresner* was a Florida state court case in which this Court, in an exercise of discretion, certified doubtful questions of state law to the Florida Supreme Court since the resolution of these state law questions might obviate the need for this Court to determine the constitutional issues involved. *Aldrich* arose in the West Virginia state courts and was concerned with the effect to be given to a Florida judgment under the full faith and credit clause. These cases obviously lend no support to the suggestion that lower federal courts sitting in diversity jurisdiction cases are *obligated* to certify questions of state law to the Florida Supreme Court when no

federal questions are even potentially involved and where none of the parties requests such certification.

The case at bar does not involve, as petitioners would have it, a "refusal" by the Court of Appeals to certify the question. Never having been asked to do so by the parties, the Court could not have "refused." Indeed, in deciding the issues put before it, the Court of Appeals was properly performing its duties under diversity jurisdiction. *Meredith* v. *City of Winter Haven*, 320 U.S. 228 (1943).

Petitioners' reliance upon *Clay* v. *Sun Insurance Office*, 363 U.S. 207 (1960) is also clearly misplaced. *Clay* reached this Court because the Court of Appeals for the Fifth Circuit had unnecessarily decided a federal constitutional question in a case which might have otherwise turned entirely on an issue of state law. Vacating the decision, this Court remanded the case to the Court of Appeals for a determination of the relevant state law. In strongly suggesting, but not explicitly mandating, use of the Florida certification procedure, this Court took particular note of the fact that the Court of Appeals had admitted that "it could not on the available materials make a confident guess how the Florida Supreme Court would construe the statute." 363 U.S. at 212.

The case at bar sharply contrasts with *Clay* in both particulars: first, there is no federal law question at issue and therefore no possibility of an unnecessary constitutional adjudication; and second, the Court of Appeals in the instant case did not express an inability to determine the state law question at issue and, in fact, determined it in a carefully reasoned opinion.

It should be emphasized that the issue before this Court is not, as petitioners would have it, whether this Court agrees with the general proposition that the Florida certification procedure is a useful device, or whether the Court

of Appeals might have used it, but rather whether the Court of Appeals committed reversible error by deciding the merits of this case and not using this discretionary procedure where the parties argued the merits of the case to the Court of Appeals and neither side ever suggested certification.

This Court has frequently expressed its reluctance to consider issues not raised in the courts below. See e.g. *Emspak* v. *United States,* 349 U.S. 190, 198 (1955); *Federal Trade Commission* v. *Travelers Health Association,* 362 U.S. 293, 298 n. 4 (1960).

Moreover, whatever "rights" petitioners may have had to have the issues of Florida law in this case certified to the Supreme Court of Florida instead of having them decided by the Court of Appeals for the Second Circuit surely must have been waived by petitioners when they argued the merits of this case to the Court of Appeals and never even raised the question of certification. See *Yakus* v. *United States,* 321 U.S. 414, 444 (1944).

Where a litigant objects to having an issue decided by a particular Judge or Court, he cannot wait until after an adverse decision has been rendered before raising his objection. *Laughlin* v. *United States,* 151 F. 2d 281 (D.C. Cir. 1945), cert. denied 326 U.S. 777 (1945); *In Re United Shoe Machinery Corp.,* 276 F. 2d 77 (1st Cir. 1960); *Pacheco* v. *People,* 300 F. 2d 759 (1st Cir. 1962); *Arnold* v. *McGuinness,* 289 F. Supp. 210 (N.D. Cal. 1968), aff'd. 400 F. 2d 392 (9th Cir. 1968), cert. denied 394 U.S. 918 (1969). As the Court of Appeals for the First Circuit stated in *United Shoe, supra* at 79, in an analogous situation involving a motion for disqualification of a judge:

> "One of the reasons for requiring promptness in filing is that a party, knowing of a ground for requesting

disqualification, can not be permitted to wait and decide whether he likes subsequent treatment that he receives. As was said in Sate ex rel. Shufeldt v. Armijo, 1935, 39 N.M. 502, at page 506, 50 P.2d 852, at page 855,

> "A litigant cannot experiment with the judge presiding over the case * * *.
>
> "* * * We cannot permit a litigant to test the mind of the trial judge like a boy testing the temperature of the water in the pool with his toe, and if found to his liking, decides to take a plunge."

It is respectfully submitted that the petitioners' claim that the Court of Appeals committed reversible error in not certifying the issues of Florida law to the Supreme Court of Florida in this case, coming as it does only after petitioners "tested the water" and found it not to their liking and without any prior suggestion from any party that the Court of Appeals should do anything other than decide the issues in this case, is clearly without merit and does not warrant the granting of certiorari.

II

The Court of Appeals Did Not Commit Reversible Error In Not Abstaining From a Decision On the Merits In This Case Where the Merits Were Fully Briefed and Argued to the Court and None of the Parties Requested the Court to Abstain From Deciding the Case.

Petitioner Lehman Brothers also urges that this was a proper case for invoking the doctrine of abstention, citing cases such as *Louisiana Power & Light Co.* v. *Thibodaux,* 360 U.S. 25 (1959) and *Kaiser Steel Corp.* v. *U. S. Ranch Co.,* 391 U.S. 593 (1968), notwithstanding the fact that petitioners never requested the Court of Appeals to

abstain from a decision in this case. It is doubly inappropriate for this issue to be raised here by Lehman Brothers for the first time since it could have been raised previously not only in the Court of Appeals but also in the District Court. For the reasons set forth in Point I *supra*, we respectfully submit that the petitioners, by not raising this issue in either of the courts below must be deemed to have waived whatever rights they may have had under the abstention doctrine and that they should not be permitted to raise this issue for the first time in this Court.

Moreover, the abstention doctrine, even had it been properly raised below, is inapplicable. This Court stated in *Meredith* v. *City of Winter Haven, supra:*

> "Congress having adopted the policy of opening the federal courts to suitors in all diversity cases involving the jurisdictional amount, we can discern in its action no recognition of a policy which would exclude cases from the jurisdiction merely because they involve state law or because the law is uncertain or difficult to determine." 320 U.S. at 236.

And this view was reaffirmed in *McNeese* v. *Board of Education*, 373 U.S. 668 (1963), where this Court stated once again that in diversity jurisdiction, the "difficulties and perplexities of state law are no reason for referral of the problem to the state court." 373 U.S. at 673 n.5.

This case presents none of the classic conflicts which have led this Court to order abstention under certain limited conditions. Thus, there is no possibility here that a federal court might misconstrue a complex state regulatory scheme, as in *Alabama Public Service Commission* v. *Southern Ry. Co.*, 341 U.S. 341 (1951), unnecessarily decide a federal constitutional issue, as in *Reetz* v. *Bozanich*, 397 U.S. 82 (1970), or unnecessarily involve itself in the interpretation

of local condemnation statutes, as in *Louisiana Power & Light Co.* v. *Thibodaux, supra.** Nor is this a situation where a state court action between the same parties is pending, as in *Kaiser Steel Corp.* v. *U. S. Ranch Co., supra.* Acceptance of Lehman's argument that "an entire absence of decisions", presumably on *any* point of state law, "mandates" abstention (Lehman Pet., p. 18) would effectively oust the federal courts from jurisdiction to decide any diversity case containing an unsettled question of state law and would therefore deprive litigants of the very choice of forum which is guaranteed by the Judical Code. While the abstention cases may have carved out exceptions to the *Meredith* rule in certain well defined areas, they have not, as petitioners imply, read *Meredith* off the books.

Petitioners' claim that the Court of Appeals committed reversible error in failing to abstain from a decision in this case is clearly unfounded and does not present any issue which would warrant this Court granting certiorari.

III

The Court of Appeals Decided the Merits of This Case in Accordance With the Principles of *Erie R. Co.* v. *Tompkins.*

In their vain attempt to have the merits of this case reheard, petitioners further argue that the Court of Appeals for the Second Circuit somehow failed to carry out its duties under *Erie R. Co.* v. *Tompkins,* 304 U.S. 64 (1938).

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* This Court's decision in *Thibodaux, supra,* upholding a District Judge's power to abstain *sua sponte* in limited circumstances, certainly lends no support to petitioners' claim herein, raised only *after* an adverse decision, that the Court of Appeals should not have decided the issue before it.

Under *Erie,* of course, the Court of Appeals was required to ascertain and apply the appropriate state law to the facts and circumstances of the case. Examination of that Court's analysis of the issues plainly demonstrates that it scrupulously performed that duty.

Since plaintiffs did not challenge the District Court's finding that under applicable choice of law principles, Florida law governed the action, the Court of Appeals proceeded to a discussion of the facts in the context of Florida law. In applying the law of Florida, the Court of Appeals' first problem was to determine if it could look to the unanimous New York decision in *Diamond* v. *Oreamuno, supra,* as persuasive authority. The Court noted that:

> "• • • in the absence of a clearly enunciated state rule, the federal court may turn to the law of other jurisdictions for assistance in determining how the state court would most likely decide the case if the state court were presented with the questions being litigated in the federal court." *Baxter* v. *Lancer Industries, Inc.,* 213 F. Supp. 92 (EDNY 1963), app. denied, 324 F. 2d 286 (2 Cir. 1963); *Locke Manufacturing Companies* v. *United States,* 237 F. Supp. 80 (D. Conn. 1964). (App. 7a)

Since the Court found no Florida decisions directly in point the Court concluded that it was:

> "• • • both proper and practical for this court to turn for guidance to the body of law of other jurisdictions and particularly to that of New York where the resolution of the issues in the *Diamond* case, decided by the New York Court of Appeals, bears on the issues in the case before us." (App. 7a)

The Court's express objective was:

> "• • • to interpret *Diamond* as the Florida court would probably interpret it and to apply *Diamond* as so interpreted to the facts presented here." (App. 7a)

After discussing *Diamond* and its applicability to the facts in the instant case, the Court again noted that it sat "as a court of equity viewing the case as a Florida court would probably view it" and stated:

> "• • • we cannot agree that the 'stretch' of *Diamond* does not reach the defendants in this case. We find nothing in the language of *Diamond* to suggest that co-venturers of the director who breaches his duty should not be subject to the same liabilities as those of the director himself for the misuse of corporate information." (App. 8a-9a)

The Court indicated that its interpretation of *Diamond* and the application of the rationale of *Diamond* to the issues in the instant case were in accord with the general rule set forth in various authorities (*Oil & Gas Ventures—First 1958 Fund Ltd.* v. *Kung*, 250 F. Supp. 744 (1966); see, e.g., *Jackson* v. *Smith*, 254 U.S. 586, 589 (1921); *Sexton* v. *Sword S.S. Line, Inc.*, 118 F. 2d 708, 711 (2 Cir. 1941); *Bankers Life and Casualty Co.* v. *Kirtley*, 338 F. 2d 1006, 1013 (8 Cir. 1964)) (App. 9a), that "one who knowingly participates in or joins in an enterprise whereby a violation of a fiduciary obligation is effected is liable jointly and severally with the recreant fiduciary." (App. 9a)

The Court also noted that its conclusion that a valid claim was stated against the defendants in this case was also supported by Florida case law, citing *Quinn* v. *Phipps*, 93 Fla. 805, 113 So. 419 (1927), which held that "the duty of a fiduciary not to misuse the property of a cestui extends

not only to the 'technical fiduciary' but also to others who are placed in a position of trust" (App. 11a) and that persons who acquire confidential information which is "owned" by someone else are, under Florida law, fiduciaries. (App. 11a)

Finally, the Court held that Lehman Brothers and Simon were accountable for the profits made by their tippees:

> "• • • Lehman Brothers and Simon obviously misused inside information as much as Diversified and Investors misused it, and therefore we fail to see how equity would be furthered by imposing liability only on the Funds and not on the other participants who supplied the Funds with the inside information. It is well established that the liabilities of persons engaged in a joint enterprise to commit a wrong are both joint and several liabilities and each participant is liable to account for the profits of the other participants." *Marcus* v. *Otis,* 168 F. 2d 649 (2 Cir. 1948), *modified,* 169 F. 2d 148 (2 Cir. 1948); *Solomon* v. *United States,* 276 F. 2d 669 (6 Cir. 1960), *cert. denied,* 364 U.S. 890 (1960), *reh. denied,* 364 U.S. 939 (1969). (App. 12a)

Petitioner IDS strangely contends that the Court of Appeals did not adequately discuss Florida law since it only cited two Florida cases in its opinion. Yet IDS itself cited no other Florida cases in its brief to the Court of Appeals (other than the cases which plaintiffs had cited which IDS claimed were "inapposite"). Under these circumstances IDS is hardly in a position to claim that the Court of Appeals ignored Florida law.

Furthermore, while petitioners disagree with the Court of Appeals' interpretation of *Diamond* and with its determination of Florida common law in this case, the petitioners did not cite to the Court of Appeals any Florida cases (or, indeed, any cases at all) to the contrary, nor

have petitioners cited any cases to this Court in their petitions for certiorari which indicate that the Court of Appeals "has decided an important question of local law in a way probably in conflict with applicable local decisions." See *Ruhlin* v. *New York Life Insurance Co.*, 304 U.S. 202, 206 (1938). The record is simply barren of any support for petitioners' claim that the Court of Appeals violated *Erie*. In short this is not a case where a federal court has attempted to substitute its judgment for that of controlling state authorities as to what the state law ought to be, see *West* v. *American Telephone & Telegraph Co.*, 311 U.S. 223 (1940); on the contrary it is an example of how a scrupulous Court of Appeals under *Erie* rigorously analyzed and applied existing principles of state law to the situation at hand. Accordingly, there is clearly no basis for certiorari to be granted in this case where there is no federal question involved. *Ruhlin* v. *New York Life Insurance Co., supra; M/V Tungus* v. *Skovgaard*, 358 U.S. 588 (1959); *Pierson* v. *Ray*, 386 U.S. 547, 558 n. 12 (1967); *Commissioner of Internal Revenue* v. *Bosch's Estate*, 387 U.S. 456, 462 (1967).

CONCLUSION

The petitions of Benjamin Simon, IDS *et al.*, and Lehman Brothers for writs of certiorari to the Court of Appeals for the Second Circuit should be denied.

Respectfully submitted,

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APPENDICES

Appendix A

Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 81 and 82—September Term, 1972.

(Argued October 17, 1972 Decided May 10, 1973.)

Docket Nos. 72-1373, 72-1375

JACOB SCHEIN and MARVIN H. SCHEIN,

Plaintiffs-Appellants,

—v—

MELVIN CHASEN, INVESTORS DIVERSIFIED SERVICES, INC., LEHMAN BROTHERS, INVESTORS VARIABLE PAYMENT FUND, INC., BENJAMIN SIMON, IDS NEW DIMENSIONS FUND, INC., EUGENE S. SIT, JAMES R. JUNDT, and LUM'S, INC.,

Defendants-Appellees.

ANTONE F. GREGORIO, individually and as representative of all persons similarly situated as a class under Rule 23, F.R.C.P.,

Plaintiff-Appellant,

—v—

LUM'S, INC., MELVIN CHASEN, LEHMAN BROTHERS, BENJAMIN SIMON, INVESTORS DIVERSIFIED SERVICES, INC., EUGENE S. SIT, and JAMES R. JUNDT,

Defendants-Appellees.

Appendix A—Opinion of the Court of Appeals

Before:

WATERMAN, SMITH and KAUFMAN,

Circuit Judges.

Invoking the diversity jurisdiction of the court, plaintiffs in three cases consolidated below sued derivatively in United States District Court for the Southern District of New York, Tyler, *J.*, alleging that defendants were jointly and severally liable under state corporation law for the profits realized by the defendants Mutual Funds through their trading on the New York Stock Exchange in derivative defendant's stock on the basis of non-public material inside information. An order granting summary judgment was granted to defendants and in two of the consolidated actions the parties have argued appeals.

Reversed and remanded for further proceedings consistent with this opinion.

DONALD N. RUBY, Wolf, Popper, Ross, Wolf, & Jones, New York City, *for Schein and Gregorio.*

SCHLIFKIN & BERMAN, Chicago, Ill., *for Gregorio.*

LAURA BANFIELD, DAVID HARTFIELD, JR., White & Case, New York City, *for Simon.*

JAMES J. HAGAN, Simpson, Thacher & Bartlett, New York City, *for Lehman Brothers.*

JAMES M. BERGEN, ALLAN R. FRIEDMAN, Donovan, Leisure, Newton & Irvine, New York City, *for Investors Diversified Services, Inc., Investors Variable Payment Fund, Inc., and IDS New Dimensions Fund, Inc.*

Appendix A—Opinion of the Court of Appeals

WATERMAN, *Circuit Judge:*

Plaintiffs-appellants are stockholders in Lum's, Inc., a Florida corporation primarily engaged in restaurant franchising. Invoking the diversity jurisdiction of the court, they sued derivatively in the Southern District of New York alleging that the defendants were jointly and severally liable to Lum's for actionable wrongs which the defendants had committed against Lum's. The individual defendants were Melvin Chasen, a resident of Florida, president of Lum's, Benjamin Simon, a stockbroker employed in Chicago, Ill. by defendant Lehman Brothers, Eugene S. Sit, portfolio manager of defendant IDS New Dimensions Fund, Inc., a Mutual Fund, and James R. Jundt, manager of defendant Investors Variable Payment Fund, Inc., a Mutual Fund. Each of the four individual defendants moved for dismissal on the ground that they had not been validly served under the New York Long Arm Statute (CPLR §§ 313, 302(a)) and that the court below had no personal jurisdiction of them. Sit's and Jundt's motions were granted prior to the filing of the order appealed from, Chasen's was granted concurrently therewith, and Simon's has apparently not been acted upon.[1] The defendants Lehman Brothers, a partnership engaged in stock brokerage and investment counseling, the three corporations, engaged in managing investment port-

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1 Plaintiffs-appellants have not appealed the order dismissing the actions against Chasen, Sit and Jundt. Simon filed a similar dismissal motion but the trial court did not decide it. Simon was dismissed as a defendant by the court's order dismissing the complaints against all defendants for failure to state a cause of action under 12(b)(6) of the Fed. R. Civ. P. Simon contends on this appeal that irrespective of our action on the lower court's dismissal of the complaints under 12(b)(6), we should dismiss the action against him because he has not been validly served. However, inasmuch as the trial court has not reached this question, we decline to address it on this appeal, and leave its resolution to the trial court upon remand.

folios and in buying and selling the corporate securities of publicly held corporations, Chasen, and Simon, all moved for dismissal on the ground that the complaints failed to state a cause of action under Florida law. Plaintiffs claimed that New York law should govern the rights and liabilities of the parties, and that even if Florida law were the applicable law they should still prevail. Holding that Florida law was the proper state law to apply, Judge Harold R. Tyler, Jr., by written order, *sub nom Gildenhorn* v. *Lum's, Inc.*, opinion reported at 335 F.Supp. 329 (SDNY 1971), granted the motion to dismiss for failure to state a claim upon which relief could be granted.

On this appeal plaintiffs claim only that Judge Tyler erred in dismissing the complaints for failure to state a cause of action.[2] They do not appeal Judge Tyler's order dismissing Chasen as a defendant or his finding that the substantive law of Florida governs the action.[3] Inasmuch as the court is passing only upon the sufficiency of the complaints, we necessarily accept the allegations of the complaints as true. For reasons which follow, we hold that the complaints do state a cause of action and we reverse the judgment below and remand to the district court for further proceedings there in the light of this holding.

The facts alleged in this case fall within the perimeter of the much-discussed problem of unfair trading in corporate securities. In November of 1969 Chasen, who was president and chief operating officer of Lum's addressed a seminar of about sixty members of the securities industry with reference to Lum's earnings prospects for its fiscal year

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2 In one of the original actions consolidated below, *Gildenhorn* v. *Lum's, Inc.*, 335 F.Supp. 329 (SDNY 1971) a notice of appeal was filed by plaintiff but the parties have not progressed the appeal.

3 The parties now agree that the substantive law of the State of Florida governs the action for reasons which are stated in Judge Tyler's opinion reported at 335 F.Supp. 329 (SDNY 1971).

ending July 31, 1970. He informed them that Lum's earnings would be approximately $1.00 to $1.10 per share. On January 5, 1970 he learned that this estimate was too optimistic and that, in fact, Lum's earnings would be only approximately $.76 per share. Three days later, prior to announcing the information to the public, Chasen telephoned Simon in Chicago and told Simon that Lum's would not have as profitable a year as had been expected. He specified to Simon that earnings would be approximately $.76 per share rather than the $1.00 per share which he had earlier announced. Simon knew the information was confidential corporate property which Chasen had not given out publicly. Simon immediately telephoned this information to Sit, an employee of defendant Investors Diversified Services, Inc. (IDS),[4] and Sit immediately telephoned it to Jundt, another employee of IDS. Sit and Jundt managed the stock portfolios of defendant mutual funds Investors Variable Payment Fund, Inc. (Investors) and IDS New Dimensions Fund, Inc. (Dimensions). Upon receiving the information Sit and Jundt directed the Funds to sell their entire stock holdings in Lum's and, on the morning of January 9, 1970, prior to any public announcement, Investors sold 43,000 shares of Lum's and Dimensions sold 40,000 shares. The sales were executed on the New York Stock Exchange at about 10:30 A.M. at a price of approximately $17.50 per share. At 1:30 P.M. on the same day, the New York Stock Exchange halted further trading in Lum's stock pending a company announcement. At 2:45 P.M. Lum's issued a release which appeared on the Dow Jones News Wire Service and announced that the corpora-

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4 Defendant IDS is a Minnesota corporation licensed to do business in the State of New York. IDS is the distributor and investment advisor for a number of large mutual funds including defendants Investors and Dimensions. Sit and Jundt are employed by IDS to manage the stock portfolios of Investors and Dimensions.

tion's projected earnings would be lower than had been anticipated. When trading in Lum's was resumed on Monday, January 12, 1970, volume was heavy and the stock closed at a price of $14.00 per share—$3.50 per share lower than the Funds had realized from the sales of their shares on the previous Friday.

The present defendants in this case are Lehman Brothers, Simon, and the two Mutual Funds. Chasen, Sit, and Jundt have been dismissed as defendants in that they have not been validly served under the New York State Long Arm Statute. Plaintiffs-appellants' theory of recovery is that the participants in this chain of wrongdoing are jointly and severally liable to the corporation under Florida law for misusing corporate information to their own advantage in violation of the duty they owed to Lum's, and that they must account to Lum's for the profits realized by the Mutual Funds. They do not allege in these complaints that defendants have violated any of the federal securities laws,[5] and they concede that the substantive law of Florida governs the rights and liabilities of the parties. They urge, however, that inasmuch as there are no Florida cases directly in point, the Florida court, if it were deciding the case, would look to other jurisdictions and would take a particular and special interest in the decision of *Diamond* v. *Oreamuno*, 29 A.D.2d 285, 287 N.Y.S.2d 300 (1st Dep't 1968), *aff'd* 24 N.Y.2d 494, 301 N.Y.S.2d 78 (1969), a case which plaintiffs contend supports the position they urge on this appeal.

The first question which our court must consider is whether we may look to the New York decision of *Diamond*,

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5 Lum's could apparently not prevail as a plaintiff in a Rule 10b-5 action in that it has not traded in its securities on its own account. See *Birnbaum* v. *Newport Steel Corporation*, 193 F.2d 461 (2 Cir. 1952), cert. denied, 343 U.S. 956 (1952). Although there are federal securities law cases pending against defendants in district court, this fact is irrelevant upon this appeal.

supra, as persuasive authority. Ideally, the federal court sitting in a diversity action applies the applicable state law as it has been enunciated by the highest court in the state. *Erie R. Co.* v. *Tompkins,* 304 U.S. 64 (1938); *Hausman* v. *Buckley,* 299 F.2d 696 (2 Cir. 1962), *cert. denied,* 369 U.S. 885 (1962). However, in the absence of a clearly enunciated state rule, the federal court may turn to the law of other jurisdictions for assistance in determining how the state court would most likely decide the case if the state court were presented with the questions being litigated in the federal court. *Baxter* v. *Lancer Industries, Inc.,* 213 F.Supp. 92 (EDNY 1963), *app. denied,* 324 F.2d 286 (2 Cir. 1963); *Locke Manufacturing Companies* v. *United States,* 237 F.Supp. 80 (D. Conn. 1964). Our foray into the state law of Florida satisfies us that the Florida court has never faced the precise issues which are present in this action. Accordingly, it is both proper and practical for this court to turn for guidance to the body of law of other jurisdictions and particularly to that of New York where the resolution of the issues in the *Diamond* case, decided by the New York Court of Appeals, bears on the issues in the case before us. In doing so, our objective is to interpret *Diamond* as the Florida court would probably interpret it and to apply *Diamond,* as so interpreted, to the facts presented here.

Diamond v. *Oreamuno, supra,* was a stockholder's derivative action in which a shareholder of Management Assistance, Inc. (MAI) charged that two of the defendants—Oreamuno, chairman of the board of directors, and Gonzales, its president and a member of the board, had used inside information acquired by them solely by virtue of their positions with MAI in order to reap large personal profits from the sale of MAI shares, and that these profits rightfully belonged to the corporation. Chief Judge Stanley Fuld, writing for a unanimous court, held that the two

directors must account to the corporation for their profits for they had breached their duty to the corporation by using a corporate asset for their own personal advantage.

In this case we are asked to decide whether the *Diamond* holding should extend to reach third parties who, though not officers or directors of the injured corporation, are involved with directors in a common enterprise to misuse confidential corporate information for their own enrichment. Although there is no allegation in the complaints that a prior explicit agreement existed between Chasen and the defendants, it is obvious that the sequence of events detailed in the pleadings, if proved, will substantiate the existence of a common enterprise pursuant to which Chasen was to pass material information to Simon, Simon was to pass it to the Mutual Funds, and the Funds were to capitalize on it by selling Lum's stock prior to the time the material information was announced to and was available to the public. Cf. *American Tobacco Co.* v. *United States* 328 U.S. 781 (1946); *Interstate Circuit, Inc.* v. *United States*, 306 U.S. 208 (1939); *Norfolk Monument Company* v. *Woodlawn Memorial Gardens, Inc.*, 394 U.S. 700 (1969). Although defendants do not deny that they have been involved in a joint enterprise with Chasen to misuse corporate property, they argue that the doctrine of *Diamond* is not applicable here and that they cannot be held liable to Lum's because they are not Lum's fiduciaries and have not breached any duty which they owed to Lum's by cashing in on confidential information for their own advantage. Defendants Simon and Lehman Brothers make the further argument that it would be "unfair" to hold them responsible for the profits made by the Mutual Funds in that they (Simon and Lehman Brothers) did not profit personally inasmuch as neither of them traded in Lum's stock.

As a court of equity viewing the case as the Florida court would probably view it, we cannot agree that the

"stretch" of *Diamond* does not reach the defendants in this case. We find nothing in the language of *Diamond* to suggest that co-venturers of the director who breaches his duty should not be subject to the same liabilities as those of the director himself for the misuse of corporate information.[6] Indeed, the general rule has always been that "one who knowingly participates in or joins in an enterprise whereby a violation of a fiduciary obligation is effected is liable jointly and severally with the recreant fiduciary." *Oil & Gas Ventures—First 1958 Fund Ltd.* v. *Kung*, 250 F.Supp. 744 (1966); see, *e.g.*, *Jackson* v. *Smith*, 254 U.S. 586, 589 (1921); *Sexton* v. *Sword S.S. Line Inc.*, 118 F.2d 708, 711 (2 Cir. 1941); *Bankers Life and Casualty Co.* v. *Kirtley*, 338 F.2d 1006, 1013 (8 Cir. 1964). If the *Diamond* court had intended to lay down an exception to this well-known general rule it could have done so in its opinion. Moreover, in the light of the corporate interest which the *Diamond* rule is designed to protect, it is immaterial to the preservation of that interest whether the director trades on his own account in the corporation's stock or whether he passes on the information to outsiders who then trade in the corporation's stock. In either event, so long as the director is involved, the prestige and good will of the corporation may be tarnished by the public revelation that the director has been involved in unethical conduct. *Diamond, supra* at 499; accord, *S.E.C.* v. *Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1308 (2 Cir. 1971), *cert. denied*, 404 U.S.

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6 We believe Judge Tyler erred in attaching dispositive significance to the fact that in *Diamond*, supra, the complaint was dismissed against certain directors who had only "acquiesced" in the wrong. The defendants-appellees here differ from the dismissed *Diamond* defendants in that the defendants-appellees were actively engaged in furthering the transaction that resulted in the "dumping" of the Lum's stock, rather than just "acquiescing" in it. Furthermore, and even more importantly, *Diamond* was not a "joint venture" case, and there is no discussion in the *Diamond* opinion as to why the complaint was dismissed against the "acquiescing" directors.

1005, *reh. denied*, 404 U.S. 1064 (1972). Accordingly, it would be self-defeating to limit the reach of *Diamond* to directors and officers of the injured corporation who have so acted while permitting third-party co-venturers of theirs to escape liability to the corporation.

Diamond, the law of the jurisdiction in which the New York Stock Exchange is seated, has the prophylactic effect of providing a disincentive to insider trading. It is clear that this cleansing effect ought to reach third parties who, through a breach of a fiduciary relationship, become traders advantageously possessed of confidential insider knowledge. To immunize such third parties from liability to the damaged corporation would encourage insider "leaks" to outside friends and would defeat *Diamond's* purpose and effect. And, quite properly, damages for fiduciary breaches are recoverable by recourse to state law. Indeed, though the congressional policy is similar, in some cases where federal private and governmental Rule 10b-5 actions are impractical, "immunized outsiders" might escape liability altogether except for the availability of this kind of action bottomed upon the well-recognized liability of a fiduciary to those whose trust in the fiduciary has been tragically misplaced. In view of the strong desirability of tightening the law of insider trading, we would be remiss indeed if we interpreted *Diamond* as narrowly as defendants would have us interpret it. Moreover, sitting as a court of equity, we have here an obligation to determine where the equities lie among all the litigants, *Diamond, supra* at 498, and, as between the defendants and Lum's, there can be no doubt that it would be inequitable to permit the defendants to keep the rewards of the fraud.[7]

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7 This principle has been applied in analogous cases involving violations of the federal securities laws. In more than one instance, the corporation whose stock has been illegally traded has been permitted to recover conditionally in a Rule 10b-5 action because it is more equitable

Our view that all the participants in the common enterprise must assume the same risks of liability to the corporation as the offending director is supported by Florida case law dealing with the duty of a fiduciary to his cestui. The Florida courts have held that the duty of a fiduciary not to misuse the property of his cestui extends not only to the "technical fiduciary" but also to others who are placed in a position of trust. *Quinn* v. *Phipps*, 93 Fla. 805, 113 So. 419 (1927). The confidential relationship of a fiduciary as that relationship is spelled out in Florida law extends not only to "technical fiduciaries" but also to others who become "fiduciaries" through the acquisition of confidential information which is "owned" by someone else. See *Quinn* v. *Phipps*, supra at 420-421. When the defendants received their "tip" from Chasen, they were automatically clothed with a duty to Lum's not to use the information for their own selfish advantages. Compare *Brophy* v. *Cities Service Co.*, 31 Del. Ch. 241, 70 A.2d 5 (1949); *Ohio Oil Co.* v. *Sharp*, 135 F.2d 303 (10 Cir. 1943). This is firmly grounded in law and the rule is set forth in the American Law Institute's Restatement of Agency 2d §312 (1958): "A person who, without being privileged to do so, intentionally causes or assists an agent to violate a duty to his principal is subject to liability to the principal." And see Comment c to §312:

> A person who, with notice that an agent is thereby violating his duty to his principal, receives confidential information from the agent, may be enjoined from disclosing it and required to hold profits received by its use as a constructive trustee. * * * *

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for it to recoup the rewards of the fraud than for the insider who profits by misusing corporate information to keep them. See *Securities and Exchange Commission* v. *Texas Gulf Sulphur*, 446 F.2d at 1308; *S.E.C.* v. *Golconda Mining Company*, 327 F.Supp. 257 (SDNY 1971).

Therefore, if plaintiffs can prove their allegations, it would seem that liability of the Mutual Funds to Lum's must necessarily follow. Be that as it may be, however, the defendants Lehman Brothers and Simon contend that it would be inequitable to apply the rule to them because they did not personally profit by trading in Lum's stock and they hold no profits as constructive trustees of that corporation. Nevertheless, Lehman Brothers and Simon obviously misused inside information as much as Diversified and Investors misused it, and therefore we fail to see how equity would be furthered by imposing liability only on the Funds and not on the other participants who supplied the Funds with the inside information. It is well established that the liabilities of persons engaged in a joint enterprise to commit a wrong are both joint and several liabilities and each participant is liable to account for the profits of the other participants. *Marcus* v. *Otis*, 168 F.2d 649 (2 Cir. 1948), *modified*, 169 F.2d 148 (2 Cir. 1948); *Solomon* v. *United States*, 276 F.2d 669 (6 Cir. 1960), *cert. denied*, 364 U.S. 890 (1960), *reh. denied*, 364 U.S. 939 (1961). Accordingly, we hold that it would be proper to hold Lehman Brothers and Simon just as accountable for the profits made by their tippees Diversified and Investors as the tippees themselves.[8]

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8 In passing we note decisions dealing with violations of the federal securities laws which involve the imposition of liability on defendants who have occupied statuses similar to the statuses occupied by defendants in this case. Thus, in *Securities and Exchange Commission* v. *Texas Gulf Sulphur*, 446 F.2d at 1308, the same argument raised by Simon and by Lehman Brothers was raised by defendant Darke. This court held that Darke was liable as a tippor for the profits realized by his tippees. Furthermore, "tippee liability," which is analogous to the liability being imposed upon Diversified and Investors, has been established in federal cases involving violations of the securities laws. See *Ross* v. *Licht*, 263 F.Supp. 395 (SDNY 1967); *In the Matter of Cady, Roberts & Co.*, 40 S.E.C. 907 (1961).

Defendants also contend that the complaints are presently insufficient because they fail to allege with sufficient particularly the damages Lum's is claimed to have suffered. This contention is without merit. Although the Gregorio complaint fails to allege any damages to Lum's, the Schein complaint contains a general allegation of damages, and we find nothing in Florida law to require anything more than a general ad damnum allegation.[9]

Defendants also urge that inasmuch as there are private Rule 10b-5 class actions for damages, *e.g.*, *Sanders* v. *Lum's, Inc., et al.*, 70 Civ. 5331 (SDNY) and an administrative suit brought by the Securities and Exchange Commission, *SEC* v. *Lum's, et al.*, 70 Civ. 5280 (SDNY), pending in federal district court, defendants might be subjected to multiple liability if they are forced to remit to Lum's the profits the Mutual Funds made on their January 9 sales. Since appellees are fully aware of these federal court actions they are well able to protect themselves from multiple liability.[10]

Preventing those who are privy to confidential inside information from using it to their own advantage has found expression in numerous cases in the federal courts dealing with violations of the federal securities laws. See

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9 We find it unnecessary to decide whether the defendants could prevail if *neither* complaint alleged damages to Lum's. We point out, however, that Florida law is not clear on the question and *Diamond* holds specifically that an allegation of damages is not a prerequisite to a recovery. *Diamond* v. *Oreamuno*, *supra* at 499. The case cited by defendants for the proposition that damages must be alleged (*Palma* v. *Zerbey*, 189 So.2d 510 (Fla.App. 1966), cert. denied, 200 So.2d 814 (Fla. 1967)) is a one paragraph per curiam opinion of a lower Florida court, the Florida District Court of Appeals which, inasmuch as it fails to provide a discussion of the issues, we find to be totally unpersuasive.

10 See, for example, the method employed in *Securities and Exchange Commission* v. *Texas Gulf Sulphur Co.*, 312 F.Supp. 77, 93 (SDNY 1970), *aff'd in part, rev'd in part*, 446 F.2d 1301 (2 Cir. 1971), cert. denied, 404 U.S. 1005 (1971), reh. denied, 404 U.S. 1064 (1971).

Securities and Exchange Commission v. *Texas Gulf Sulphur*, 401 F.2d 833 (2 Cir. 1968), *cert. denied sub nom. Coates* v. *SEC*, 394 U.S. 976 (1969); *List* v. *Fashion Park, Inc.*, 340 F.2d 457 (2 Cir. 1965), *cert. denied*, 382 U.S. 811 (1965); *Wohl* v. *Blair & Co.*, 50 F.R.D. 89 (SDNY 1970); *Ross* v. *Licht*, 263 F.Supp. 395 (SDNY 1967); *Speed* v. *Transamerica Corp.*, 99 F. Supp. 808, 828-829 (D.Del. 1951), *aff'd*, 235 F.2d 369 (3 Cir. 1956).

Accordingly, as to those persons found to be within the jurisdiction of the court, we reverse the order appealed from and remand the case for such further proceedings below as may be consistent with the contents of this opinion.

KAUFMAN, *Circuit Judge* (dissenting):

In my view, it is no longer debatable that trading on inside information merits universal condemnation.[1] The undesirable nature of "insider trading" is reflected in the prophylactic provisions of Section 16(b) of the Securities Exchange Act of 1934 and the more general antifraud principles of Section 10b of that Act. I fully agree with Judges Waterman and Smith that one with access to material inside information concerning a corporation's affairs who knowingly purchases or sells that corporation's shares before this information has become publicly available takes unfair advantage of unknowledgeable parties to the transaction. Indeed, the factual claims contained in the complaints before us have led to two federal actions—an SEC injunctive action and a private class action under rule 10b-5—now pending in the District Court for the Southern District of New York. But the adage that hard facts make

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1 But for a contrary view, *see* H. Manne, Insider Trading and the Stock Market (1966).

bad law is about to come true here, despite Judge, later Justice, Cardozo's warning that judges are not free agents roaming at will to create law to fit the facts. *See* The Nature of the Judicial Process 141 (1921). In the absence of any viable precedent upon which to base the totally new concept of law espoused by my brothers, it is clear that they announce an extraordinary, expansive, and incorrect reading of New York law solely because of their urge to "provid[e] a disincentive to insider trading." I agree with their objective but I question the means employed.

The court holds today that a person with no relationship whatsoever—fiduciary or otherwise—to a corporation, who trades its shares on the basis of material inside information becomes, *ipso facto,* a fiduciary of the corporation whose shares he traded and, accordingly, may be required in a *shareholders' derivative action*—not a Section 10(b) or 16(b) action—to pay his profits to the corporation. With all due respect to my brothers, the tortured reasoning to which they are compelled to resort in reaching this conclusion represents a distortion of the law of agency and the law of fiduciary responsibility in which I am unable to join. Accordingly, I dissent.

Stripped of excess verbiage, the complaints in the two consolidated stockholders' derivative actions before us make the following allegations. In January, 1970, Melvin Chasen, president of Lum's, learned that an earnings estimate of between $1.00 and $1.10 per share previously released to the financial community was grossly inaccurate. A more realistic figure was $.76 per share. Chasen revealed this information on January 8, during a telephone conversation, to Benjamin Simon, an employee in Lehman Brothers Chicago office. Simon, in turn, disclosed the adverse news to Eugene Sit, portfolio manager of Investors Variable Payment Fund, Inc., who himself conveyed the information

to James Jundt, portfolio manager of IDS New Dimensions Fund, Inc. Both Sit and Jundt are employees of Investors Diversified Services, Inc. (IDS), investment adviser to the two mutual funds. During the morning of Friday, January 9, prior to any public disclosure of the reduced earnings figure, the two mutual funds sold a total of 83,000 shares of Lum's stock on the New York Stock Exchange at a price of approximately $17.50 per share. Later that day, after the Exchange halted trading in Lum's shares, Lum's publicly announced the reduced earnings forecast. Trading did not resume until the following Monday, when the closing price fell to $14.00 per share.

It is important to note at the outset that the plaintiffs in these actions, shareholders of Lum's, do not claim to have suffered any damages themselves. Rather, these derivative suits are brought "on behalf of and for the benefit of Lum's." They seek to recover for Lum's treasury the windfall profit garnered by the IDS mutual funds, and assert that all defendants are jointly and severally liable for this amount. Thus, the proper method of analysis is not to focus on the unfairness of the mutual funds' profit at the expense of their purchasers—who have their own recourse for any wrongdoing—but on the strands of duty running to the corporation from the various individuals involved. The crux of the majority's holding is that the institutional defendants—Lehman Brothers, IDS, and the two mutual funds—and their employees—Simon, Sit, and Jundt—are within the sweep of fiduciary principles announced in *Diamond* v. *Oreamuno*, 24 N.Y.2d 494, 301 N.Y.S.2d 78 (1969). But a careful examination of that case and the principles underlying it demonstrate that *Diamond* is wholly inapposite to this case.

In *Diamond*, the New York Court of Appeals dealt with a derivative action brought by a shareholder of Management Assistance, Inc. (MAI) against Oreamuno, chairman

of the board of directors of the corporation, and Gonzalez, its president. The complaint charged that by virtue of their corporate positions, these officers knew that a supplier's price increase had caused MAI's earnings to decrease by more than 75% during a one month period. According to the allegations, the two officers sold over 50,000 MAI shares at a price of $28 per share prior to public disclosure of the adverse earnings figures, after which the price per share plummeted to $11. In reviewing the Appellate Division's refusal to order dismissal of the complaint against Oreamuno and Gonzalez, Chief Judge Fuld stated at the outset that "the question presented—one of first impression in this court—is whether *officers and directors* may be held accountable to their corporation for gains realized by them from transactions in the company's stock as a result of their use of material inside information," 24 N.Y.2d at 496, 301 N.Y.S.2d at 79 (emphasis added). A careful reading of the *Diamond* opinion reveals that Oreamuno's and Gonzalez's liability in a stockholders' derivative action was grounded solely in their having breached a fiduciary duty owed by them to MAI as corporate officials.

The inapplicability of these principles to any of the appellees[2] is readily apparent. The complaints here are barren of any allegation that the appellees—or Sit or Jundt—occupied any position, such as officer, director, employee, or agent, which would create fiduciary obligations to Lum's. *Compare Brophy* v. *Cities Service Co.*, 31 Del. Ch. 241, 70 A.2d 5 (1949); *Quinn* v. *Phipps*, 93 Fla. 805, 113 So. 419 (1927). Liability in *Diamond* was predicated entirely on

2 As noted in the majority opinion, the only defendants remaining on appeal are Lehman Brothers, IDS, the two mutual funds, and Simon. The district court dismissed the actions against Chasen for lack of personal jurisdiction, a holding not challenged on appeal. Accordingly, this court need not comment on the nature and extent of Chasen's liability to Lum's because of his conduct.

such a relationship, and in its absence, the *Diamond* rationale for liability ceases to exist.

In an effort to bridge this fatal gap, the majority, without any basis in law or fact, reasons that the appellees were involved in a "joint" or "common enterprise" with Chasen, president of Lum's, "to misuse confidential corporate information for their own enrichment." By use of this interesting, but nevertheless fictional, theory, they seek to foist upon the appellees liability to Lum's for Chasen's improper behavior. But the facts alleged in the complaints are a far cry from the "conscious parallelism" cases, drawn from the antitrust field, cited as authority in the majority opinion; the facts simply do not comport with the concept of a joint enterprise, a term which implies the existence of a prior plan to carry out a mutually beneficial project. The complaints, read in the most favorable light to the plaintiffs, disclose nothing more than a seemingly unsolicited and haphazard revelation of certain information which was useful in making investment decisions. There are ample remedies under the federal securities laws to punish this conduct. But, I am unable to understand on what basis the majority transforms the appellees' spontaneous conduct into a nefarious, prearranged, and ongoing scheme so that "joint" or "common enterprise" principles can make them liable as fiduciaries of a corporation with which they have no relationship.

A primary authority upon which the majority relies, §312 of the American Law Institute's Restatement of Agency 2d, exposes the inappropriateness of holding the appellees liable to Lum's for their conduct. Section 312 provides that "A person who, without being privileged to do so, intentionally causes or assists an agent to violate a duty to his principal is subject to liability to the principal." Although Comment *c* to this section speaks generally of receipt of confidential information by a third person

from a principal's agent, the central element of liability is the third party's active and intentional aiding in the agent's violation of a duty owed to his principal. In this case, Chasen's duty to Lum's was to not disclose confidential corporate information. Yet there is not a word in the complaint charging that the appellees actively solicited the disclosure or that they had concocted a prearranged scheme with Chasen.[3] We are dealing here with an isolated transaction.

In the absence of any coherent legal theory, I cannot join my brothers in approving the use of the shareholders' derivative action device merely because, as my brothers candidly admit, to do so possibly may have a deterrent effect on "insider trading." Although developments in federal securities law indicate an expanding scope of liability for tippee traders, *see In re* Investors Management Co., Securities and Exchange Commission Release No. 34-9267 (Jul. 29, 1971) (SEC sanctioning of institutional investors who sold a corporation's shares after the corporation's underwriter revealed adverse earnings results to them); *cf. SEC* v. *Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1308 (2d Cir. 1971), *cert. denied*, 404 U.S. 1005 (1972) (affirming district court order, in SEC injunctive suit, requiring a "tippor" to divest an amount equal to his tippees' profits), the impetus for developing this expanded federal law lia-

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3 It is of no small significance that in the *Diamond* litigation, the Appellate Division affirmed dismissal of the complaint against other MAI directors—fiduciaries to the corporation—who allegedly "approved, acquiesced in or ratified" Oreamuno's and Gonzalez's transactions. 29 A.D.2d 285, 287 N.Y.S.2d 300 (1968). Despite the majority's effort in a footnote to "distinguish" this disposition, I believe the Appellate Division's action is clearly dispositive of the point before us. If the New York courts would not impose liability upon a director—a fiduciary of the corporation—who took no affirmative steps to cause or assist in a breach of a fiduciary duty by the corporation's president, I fail to see by what logic it can be urged that New York courts would hold liable a non-fiduciary who did not cause or assist in the breach.

bility—whose exact nature and scope remain in a formative stage—is the need to maintain free and honest securities markets. This need appropriately is given great weight when we consider claims under the federal securities law. But it is inapposite in determining whether, *under state common law,* tippee trading is a breach of a fiduciary duty owed to the corporation whose shares are traded, and if so, whether such a breach is remediable through use of a shareholders' derivative action.

In these actions, where jurisdiction is grounded solely in diversity of citizenship, the parties and the majority agree that our duty is to apply the law of Florida. Yet because there are no pertinent Florida decisions, the majority focuses on a New York decision, *Diamond* v. *Oreamuno, supra.* Thus, liability is founded on the conclusion of two federal judges that the Florida Supreme Court, if the instant case was before it, would look to a New York decision and, in addition, would give an unprecedented expansive reading to that case.

Despite the manner in which the majority opinion convolutes the law and the facts in this case, a view that a tippee is cloaked with state law fiduciary obligations to the corporation whose shares he trades is an unknown and untenable legal concept. Neither *Diamond*—itself a significant alteration of the common law principles applicable to an officer's or director's trading in his corporation's shares[4] —nor the law of agency support such a holding. Nothing in the majority opinion tells us why or on what grounds a New York court would hold a tippee trader liable to the corporation for his profits under common law fiduciary principles, and the court exceeds its authority by substi-

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4 *See* Note, 1970 Wis. L. Rev. 576, 577. Although not dispositive, this fact augurs against assuming the state courts could make the broad holding so readily attributed to them by the majority.

tuting its own view of what state law ought to be, for what the state law actually is.

Moreover, since the outcome of this case turns, ultimately, upon Florida law, I fail to comprehend why my brothers refuse to utilize Florida's certified question statute, Fla. Stat. Ann. §25.031.[5] This enlightened law provides for certification to the Florida Supreme Court by a federal appellate court of an unresolved question of Florida law which is determinative of a case before it and on which there are no clear, controlling Florida Supreme Court precedents. The statute states that the court, by written opinion, then may answer the certified question. *See Aldrich* v. *Aldrich*, 375 U.S. 249 (1963); *Green* v. *American Tobacco Co.*, 304 F. 2d 170 (5th Cir. 1962). The uncertainty inherent in the majority's speculation over what the Florida courts would decide if faced with this novel question of tippee liability under state common law fiduciary principles in a stockholders' derivative action would be dispelled authoritatively and finally.

Accordingly, I respectfully dissent.

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5 The supreme court of this state may, by rule of court, provide that, when it shall appear to the supreme court of the United States, to any circuit court of appeals of the United States, or to the court of appeals of the District of Columbia, that there are involved in any proceeding before it questions or propositions of the laws of this state, which are determinative of the said cause, and there are no clear controlling precedents in the decisions of the supreme court of this state, such federal appellate court may certify such questions or propositions of the laws of this state to the supreme court of this state for instructions concerning such questions or propositions of state law, which certificate the supreme court of this state, by written opinion, may answer.

This statutory authority has been implemented by Appellate Rule 4.61.

Appendix B

Opinion of the District Court for the Southern District of New York, December 16, 1971 reported *sub nom.*, *Gildenhorn* v. *Lum's Inc.*, 335 F. Supp. 329 (S.D.N.Y. 1971)

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

70 Civ. 5733 HRT

JOSEPH GILDENHORN, as Guardian for CAROL ANN GILDENHORN,

Plaintiff,

—against—

LUM'S INC., MELVIN CHASEN, LEHMAN BROTHERS, INVESTORS DIVERSIFIED SERVICES, INC., INVESTORS VARIABLE FUND, INC., and IDS NEW DIMENSIONS FUND, INC.,

Defendants.

71 Civ. 1925 HRT

ANTONE F. GREGORIO,

Plaintiff,

—against—

LUM'S INC., MELVIN CHASEN, LEHMAN BROTHERS, INVESTORS DIVERSIFIED SERVICES, INC., EUGENE C. SIT, and JAMES R. JUNDT,

Defendants.

Appendix B—Opinion of the District Court

71 Civ. 4218 HRT

JACOB SCHEIN and MARVIN H. SCHEIN,

Plaintiff,

—against—

MELVIN CHASEN, INVESTORS DIVERSIFIED SERVICES, INC., LEHMAN BROTHERS, BENJAMIN SIMON, INVESTORS VARIABLE PAYMENT FUND, INC., IDS NEW DIMENSIONS FUND, INC., EUGENE C. SIT, JAMES R. JUNDT, and LUM'S INC.,

Defendants.

TYLER, D.J.

Defendants in these consolidated actions have moved to dismiss plaintiffs' complaints upon the ground that they fail to state a claim upon which relief can be granted. Rule 12(b)(6) F.R. Civ. P. Alternatively, all defendants move this court to stay these actions pending a final determination in *Sanders* v. *Lum's, Inc. et al.*, 70 Civ. 5331, a related action pending before this court. Additionally, the individual defendants move that the complaints be dismissed as against them upon the ground that jurisdiction over their persons has not been obtained. Rules 4(e) and 12(b)(2), F.R. Civ. P.[1]

All three of these suits are derivative actions brought on behalf of Lum's Inc. ("Lum's"), a Florida corporation. Jurisdiction is claimed by virtue of diversity of citizenship. The plaintiffs' complaints are predicated on the same facts

1 Defendants Sit and Jundt, apparently unaware that I have already granted their prior motions to dismiss by order dated October 25 of this year, once again seek the same relief. As they are no longer defendants in any of these actions, their applications will not be considered.

as *S.E.C.* v. *Lum's et al.*, 70 Civ. 5280, which is also pending before this court. Briefly stated, plaintiffs' claims are based on defendants' alleged misuse of confidential corporate information. The complaints charge that defendant Melvin E. Chasen, aware as president of Lum's that the firm's 1969 earnings would be lower than had been projected, telephoned from his Florida office to defendant Simon, who is employed in the Chicago, Illinois office of defendant Lehman Brothers, Inc., and told him of the earnings' decline. Simon then transmitted the information to Sit, the portfolio manager at defendant IDS New Dimensions Fund ("Dimensions"), whose offices are in Minneapolis, Minnesota. Sit then conveyed the information to defendant Jundt, a manager and analyst for IDS Variable Payment Fund ("Variable"). It is further alleged that Sit and Jundt then caused Variable and Dimensions to sell their entire holdings in Lum's just before the public announcement of the decline in the 1969 earnings caused the stock to drop several points in trading on the New York Stock Exchange.

Plaintiffs make no argument that any of the federal securities acts would support a claim under the facts of this case. They do argue, however, that a claim for which relief can be granted can be made out under the recent decision of the New York Court of Appeals in *Diamond* v. *Oreamuno*, 24 N.Y. 2d 494, 301 N.Y.S. 2d 78 (1969). Briefly stated, that case held that corporate officers who learn of a drop in corporate earnings by virtue of their fiduciary positions and sell their shares of corporate stock before publishing information as to the loss will be liable to the corporation for any profits made thereby. Plaintiffs urge that Chasen be found liable under *Diamond* even though it is not alleged that he sold any Lum's stock belonging to

him and that the remaining defendants be so held under either a "tippee" or general conspiracy theory.

Three issues, thus, are presented to this court by these motions, the first being a choice of law problem. The defendants argue that under the applicable choice of law provisions, these cases should be decided by Florida law. Plaintiffs oppose and urge that their complaints be tested by New York law in general and by *Diamond* v. *Oreamuno, supra,* in particular. Assuming that *Diamond would apply,* this court would then have to determine whether the complaints herein can state a claim under the holding of that case. Finally, it must be decided whether the activities of the individual defendants fall within any of the provisions of the New York long-arm statute, CPLR §302(a), so as to allow out of state service to be effected upon them pursuant to CPLR §313.

In actions where jurisdiction is predicated on diversity of citizenship, this court must apply the choice of law rules of the State of New York. *Klaxon Co.* v. *Stentor Electric Mfg. Co.,* 313 U.S. 487 (1941). New York follows the general choice of law principle that the law of the state of incorporation governs the existence and extent of corporate fiduciary obligations as well as the liability for violations of such obligations. *Hausman* v. *Buckley,* 299 F.2d 696, 703 (2d Cir., 1962) and cases cited therein; *Norte & Co.* v. *Huffines,* 304 F. Supp. 1096, 1110 n.6 (S.D.N.Y., 1968). This rule was expressed in *Diamond* itself when the court stated that as regards the "• • • duties and obligations of directors and officers and their relation to the corporation and its shareholders • • • [t]he primary source of law in this area ever remains that of the state which created the corporation." *Diamond* v. *Oreamuno, supra,* at 503, 504, 301 N.Y.S. 2d at 35.

The same result would be reached by the "grouping of contacts" approach to choice of law in tort actions as enunciated in *Babcock* v. *Jackson*, 12 N.Y. 2d 473, 240 N.Y.S. 2d 743 (1963). Under this approach, a New York court will apply the law of the state of the "strongest contacts with the cause of action." *Stockwell* v. *Reynolds & Co.*, 252 F. Supp. 215, 220 n.3 (S.D.N.Y., 1965). It appears from the pleadings that this case centers in Florida rather than in New York. Chasen, a Florida citizen, allegedly received and communicated the information from Florida. Lum's was incorporated, headquartered, and, at least theoretically, damaged in Florida. Most of the other contacts appear to be scattered about the midwest, the only contact with New York being several transactions over the New York Stock Exchange. Additionally, a New York court would give more weight to the Florida contacts under the "governmental interest" theory of choice of law enunciated in *Tooker* v. *Lopez*, 24 N.Y. 2d 569, 301 N.Y.S. 2d 519 (1969), because Florida has the paramount interest in defining and enforcing fiduciary obligations owing to corporations incorporated and doing business within its borders. Accordingly, I find that under any conceivable test, a New York court would apply Florida law to this case.

Under present Florida case law, a plaintiff in a derivative action must prove that the corporation has been damaged by the alleged breach of fiduciary trust. Although the highest court in that state has apparently not considered the matter, several District Courts of Appeal have held on various occasions that a complaint which fails "• • • to indicate both wrongful acts and damage to the corporation" must be dismissed. *Palma* v. *Zerby*, 189 So.2d 510, 511 (Fla. D.C. App., 1966), *cert. denied* 200 So.2d 814 (and cases cited therein).

While it is apparently required that the damage to a corporation be alleged, the Florida cases shed no light on the specificity required for pleading corporate damage. Thus, though the Gildenhorn and Gregorio complaints might be insufficient under Florida law for failing to allege any damage to the corporation at all, the Schein complaint, which contains only a bare allegation that Lum's was damaged, might conceivably be held to be sufficient by a Florida court. Furthermore, I am not unmindful of the possibility that, were a Florida court to hear this case, *Diamond* v. *Oreamuno, supra,* would be argued to it. Because of the possibility that the *Diamond* rationale might be followed in Florida, it is desirable that this court determine whether these complaints state a claim under *Diamond* for which relief can be granted.

It is clear that the complaints in these actions go far beyond the narrow holding of *Diamond*. In that case, the New York Court of Appeals held that a corporate fiduciary is liable for profits which he realizes from a sale of stock motivated by inside information received by him in his corporate position. None of the defendants in these actions fit into this mold. Chasen, as president and chief operating officer of Luma's, was certainly a fiduciary of that corporation. None of the complaints, however, allege that he did anything more than pass the inside information to defendant Simon, and there are no allegations that Chasen sold any of his Lum's stock or derived any gain, monetary or otherwise, from the sales that ultimately occurred. On the other hand, the mutual fund defendants would have profited if, as alleged, they sold their 83,000 shares of Lum's stock on the basis of Chasen's inside information. It can scarcely be maintained, however, that the mutual fund defendants were officers or directors of Lum's or

owed any fiduciary duties whatsoever to that corporation. The broker-dealer defendants fail to come within either of the *Diamond* perameters as they were not fiduciaries of the corporation and did not profit by virtue of the sales.

Plaintiffs, of course, urge a more expansive view of *Diamond*. They point to portions of the opinion indicating that the purpose of the holding was to protect the corporation's interest in "* * * maintaining a reputation of integrity, an image of probity for its management and in insuring the continued public acceptance and marketability of its stock." *Diamond* v. *Oreamuno, supra,* at 499, 301 N.Y.S. 2d at 82. Thus, say plaintiffs, if the purpose of *Diamond* is to maintain a corporation's integrity on the securities exchanges, it should make no difference whether an officer or director sells his own stock or passes the inside information to others who in turn sell their stock and profit thereby. While the harm done to the corporation might be equal in either instance, there is evidence that *Diamond* was not intended to cover the latter situation. As Chief Judge Fuld explained, the purpose of that derivative action was to allow individual shareholders to be "* * * 'private attorney generals' to * * * enforce proper behavior of corporate officers." *Diamond* v. *Oreamuno, supra,* at 503, 301 N.Y.S. 2d at 85. It is implicit that the jurisdiction of these "private attorney generals" would be limited to the corporation in which they are shareholders. It could not, with any logic, be extended in a derivative action to cover outside individuals, corporations, or institutions who are subject to other private and governmental restraints on their behavior. Furthermore, in affirming the dismissal of the *Diamond* complaint against other board members who were alleged to have aided the defendants in concealing their activities, the New York Court of Appeals made it quite

clear that *Diamond* extends only to corporate fiduciaries who actually profit by inside information and does not cover aiders and abettors and/or conspirators. In view of the fact that the New York Court of Appeals could not bring itself to find liability for inter-corporate conspirators, I fail to perceive how this court could extend *Diamond* to cover extra-corporate conspirators and tippees. Accordingly, I conclude that with regard to all defendants save Chasen, the complaints herein fail to state a claim for which relief can be granted.

On the other hand, Chasen, as a corporate officer, might well come within the *Diamond* holding. Although it could be plausibly argued that *Diamond* would not apply to Chasen because of the failure to allege that he sold any stock and profited thereby, it might also be maintained that a New York court could find liability in light of the numerous statements in *Diamond* to the effect that the purpose of the holding is to prevent corporate misfeasance. This question, however, need not be reached because service of process upon Chasen was improper.

In diversity actions, this court's jurisdiction is determined by the law of the State of New York. Rule 4(d)(7), F.R. Civ. P. Because Chasen is not a New York resident and was not served in New York, jurisdiction of his person depends on the New York long-arm statute, CPLR §302(a). It is plaintiffs' assertion that jurisdiction was obtained over Chasen because he set in motion events which culminated with the alleged sale of 83,000 shares of Lum's stock over an exchange located in New York. While I am aware that the scope of CPLR §302(a) has been broadly construed, I fail to see how it can be read to cover the facts in this case.

While it is settled that one can "transact business" within the meaning of CPLR §302(a)(1) through an agent, *Parke-Bernet Galleries, Inc.* v. *Franklyn*, 26 N.Y.2d 13, 308 N.Y.S. 2d 337 (1970), a New York Court would decline jurisdiction of a defendant who merely telephones a single order from outside the state. *Katz & Son Billiard Prods.* v. *Correale & Sons*, 20 N.Y. 2d 903, 285 N.Y.S. 2d 871 (1967). It seems obvious that Chasen, who did not place the order to sell the Lum's stock in question, did not "purposefully" avail himself "of the privilege of conducting activities" within New York, thereby "invoking the benefits and protections of its laws." *Hanson* v. *Denckla*, 357 U.S. 235, 253 (1958).

Plaintiffs next argue that the sale of stock over a national exchange in New York was a "tortious act within the state" and that jurisdiction could be found under CPLR §302(a)(2). While such a sale will confer jurisdiction in some cases, *Cooper* v. *North Jersey Trust Co. of Ridgewood, New Jersey*, 250 F. Supp. 237 (S.D.N.Y., 1965), CPLR §302(a)(2) can apply only where the non-resident defendant committed the tort in New York. That the alleged tort here may have been completed or "came to rest" in New York will not confer jurisdiction unless the acts or omissions complained of also occurred in New York. *Feathers* v. *McLucas*, 15 N.Y. 2d 426, 261 N.Y.S. 2d 8 (1965). *Cooper* v. *North Jersey Trust Co. etc., supra*, is not inconsistent as the defendants in that case were physically in New York when they allegedly committed the tort there in issue. As it is nowhere alleged that Chasen committed a tortious act in New York, no jurisdiction of his person can be claimed under CPLR §302(a)(2).

Finally, there can be no jurisdiction under CPLR §302 (a)(3). As the statute clearly states, the tortious act must

cause injury to persons or property in New York. Insofar as none of the non-resident plaintiffs in these cases have alleged that any injury occurred in New York, their invocation of this provision is futile.

Defendant Chasen's motion to dismiss is granted on the ground that no jurisdiction was ever obtained of his person. Rule 12(b)(2) F.R. Civ. P. The motions of the remaining defendants to dismiss under Rule 12(b)(6) F.R. Civ. P. are hereby granted. In view of these rulings, defendants' alternative motion for a stay of these actions need not be reached.

Settle orders accordingly.

Dated: December 15, 1971

H. R. Tyler, Jr.
U.S.D.J.

FILED
OCT 24 1973
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-439

LEHMAN BROTHERS,

Petitioner,

v.

JACOB SCHEIN; MARVIN H. SCHEIN; ANTONE F. GREGORIO; LUM'S INC.; MELVIN CHASEN; BENJAMIN SIMON; INVESTORS DIVERSIFIED SERVICES, INC.; INVESTORS VARIABLE PAYMENT FUND, INC.; IDS NEW DIMENSIONS FUND, INC.; EUGENE S. SIT; and JAMES R. JUNDT,

Respondents.

PETITIONER'S REPLY TO RESPONDENTS' BRIEF IN OPPOSITION

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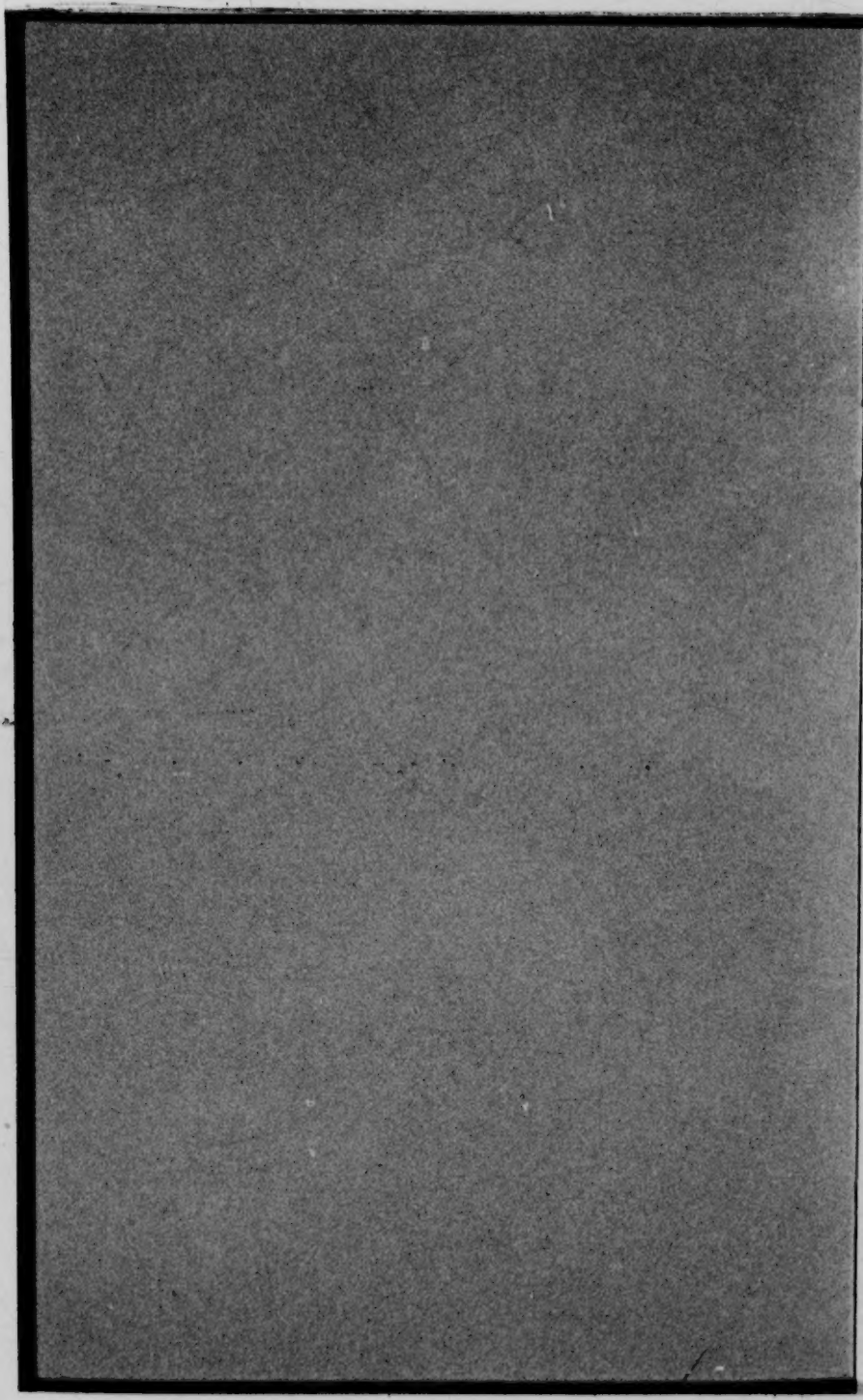
October 24, 1973



IN THE

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LEHMAN BROTHERS,

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JACOB SCHEIN; MARVIN H. SCHEIN; ANTONE F. GREGORIO; LUM'S INC.; MELVIN CHASEN; BENJAMIN SIMON; INVESTORS DIVERSIFIED SERVICES, INC.; INVESTORS VARIABLE PAYMENT FUND, INC.; IDS NEW DIMENSIONS FUND, INC.; EUGENE S. SIT; and JAMES R. JUNDT,

Respondents.

PETITIONER'S REPLY TO RESPONDENTS' BRIEF IN OPPOSITION

Petitioner Lehman Brothers ("Lehman") respectfully submits this brief in reply to contentions made in the brief of respondents Schein and Gregorio in opposition to the grant of the writ of certiorari in this case.

The Refusal to Abstain and to Employ Certification

Respondents contend on several grounds that the court below was correct in announcing an extraordinary new rule as "the law of Florida" and in refusing to employ Florida's statutory certification procedure, which would have permitted the state court to decide the important issue of

Florida public policy that governs this case. All of the grounds asserted are erroneous:

1. Respondents assert that *Meredith* v. *City of Winter Haven*, 320 U.S. 228 (1943), and *McNeese* v. *Board of Education*, 373 U.S. 668 (1963), hold abstention improper here. *Meredith*, as we have pointed out (Pet. 17-18), is distinguishable and has been succeeded by *Louisiana Power & Light Co.* v. *City of Thibodaux*, 360 U.S. 25 (1959), where the Court refused to allow a federal court to determine an important issue of state policy by "a forecast rather than a determination," *id.*, 27, and instead ordered abstention. And in *Kaiser Steel Corp.* v. *W.S. Ranch Co.*, 391 U.S. 593 (1968), this Court, in a unanimous summary reversal, held that the federal courts should abstain to permit the state courts to settle an unresolved question of state law which was bound to recur. Moreover, respondents wholly ignore the fact that the instant case can be settled by a certification procedure which involves none of the usual cost and delay of abstention and sacrifices none of the purposes of diversity jurisdiction.

McNeese was a suit to vindicate federal rights under the Civil Rights Act, 42 U.S.C. § 1983. It held that such rights are not conditioned by any duty to exhaust state administrative remedies, since it was "immaterial whether [the state officials'] conduct is legal or illegal as a matter of state law," *id.* 674, and anyway it was "by no means clear," *id.*, that the state law gave an effective remedy. Here, in contrast, the case turns exclusively on Florida law, and it is plain that the Florida certification procedure provides an effective means to determine authoritatively what that law is.

2. Respondents assert that the duty to abstain and to certify the issue somehow turns on the consent of the parties (R. Br. 11-12). This is erroneous. There was no such

consent in *Kaiser Steel, supra,* nor in *Thibodaux,* and in both cases abstention was ordered.

3. Rather than focusing on the legal standards that establish the duty to abstain, respondents repeatedly argue that such procedure is "optional" and "discretionary" (R. Br. 9, 11, 12, 14), as if no standards existed at all. But standards do exist. This Court most recently held in *Kaiser Steel* that an issue of recurrent and primary concern to a state should be settled by the courts of that state. Otherwise a federal court's tentative decision, as in this case, to adopt a unique rule of law threatens to cause an injustice in the particular case and to interfere needlessly with the development of important state policies.

4. Respondents say there is no need for certification, since the court below "did not express an inability to determine the state law question at issue and, in fact, determined it . . ." (R. Br. 13). This argument ignores that there are no Florida precedents on point, and that the court below resolved the case only by boldly adopting and then expanding a New York rule that has been accepted in no other state. If the duty to abstain can be avoided merely by forging onward to decision at whatever cost to the law, then that duty is illusory. This Court has held otherwise, most recently in *Kaiser Steel.*

5. Respondents state several times that Lehman never asked the court below to certify the central issue herein to the Supreme Court of Florida (R. Br. 9, 10, 12, 13, 14, 15), and that the issue should thus be viewed as waived. This argument is without merit. Abstention has been ordered by this Court on its own motion even in a diversity case. *United Gas Pipe Line Co.* v. *Ideal Cement Co.,* 369 U.S. 134 (1962).

In any case respondents are factually in error. Lehman, like the petitioner in *Kaiser Steel,* specifically sought cer-

tification in its petition for rehearing in the court below (Suggestion for Rehearing in Banc by Appellee Lehman Brothers, at 9-10 (May 24, 1973)), as we have already pointed out (Pet. 12). Moreover Judge Kaufman, in dissent, urged his brothers to use certification, failing to comprehend why they refused to do so (31A). The majority below clearly considered the certification procedure and refused to use it.

6. Respondents urge furthermore that abstention and certification are improper here since the case raises no question of federal law (R. Br. 12-13). This position is clearly rejected by *Kaiser Steel* and *Thibodaux*.

7. Respondents claim that certification is unnecessary here since "the issues did not involve . . . matters peculiar to local Florida law, but rather involved a determination of Florida common law" (R. Br. 12), which, respondents claim, the court could derive from out-of-state authorities. But Florida's common law *is* its "local law," and it is just such "local issues", see *W. S. Ranch Co.* v. *Kaiser Steel Corp.*, 388 F.2d 257, 264 (CA10), *rev'd*, 391 U.S. 593 (1968), with recurrent impact that this Court and the Court of Appeals for the Fifth Circuit have referred to state courts (see Pet. 30-33). The lesson of *Erie R.R.* v. *Tompkins*, 304 U.S. 64 (1938), is that federal courts are not free to decide such issues for the states, either by reference to general principles or, as here, by selecting the law of another state which has sharply broken from the majority rule (see Pet. 33-36).

8. Respondents attempt to distinguish *Kaiser Steel Corp.* v. *W. S. Ranch Co.*, *supra*, on the sole ground that in this case no state court action between the same parties

is pending (R. Br. 17).[1] The distinction is meaningless. The most practical means by far for a Florida court to resolve the main issue in this case is by certification to the Supreme Court of Florida. Unlike an ordinary civil action, such procedure could not be initiated by Lehman alone and required action by the court below. Lehman asked the court to certify the issue, and it refused; no more can be required.

The Conflicting Fifth Circuit Rule

Respondents express doubt that the central issue in this case would have been certified to the Supreme Court of Florida, had this case come to the Fifth Circuit (R. Br. 11-12). They cite several cases for the proposition that the Fifth Circuit has on occasion refused to certify an important, recurring issue involving unsettled principles of Florida law (R. Br. 11). These citations are erroneous.[2] The Fifth Circuit plainly would employ certification in a

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1. The state court action in *Kaiser Steel* was not begun until after the petitioner lost in the Court of Appeals, 388 F.2d at 266 n. 17; this Court nonetheless ordered that the federal courts should abstain so that the issues could be resolved in that state proceeding.

2. *Habecker* v. *Young*, 474 F.2d 1229 (CA5 1973) (doctrine of equitable adoption "recognized in Florida for several years," *id.*); *Pacific Indem. Co.* v. *Broward County*, 465 F.2d 99 (CA5 1972) (notice requirement in suit against county; " 'settled law'," *id.*, 102); *Motor Vehicle Cas. Co.* v. *Atlantic Nat'l Ins. Co.*, 374 F.2d 601 (CA5 1967) (construction of insurance policy; issue "neither intricate nor repetitive," *id.*, 602; principal issue had been determined before procedure for certification was established, *id.*, 603 n. 7); *Greer* v. *Associated Indem. Corp.*, 371 F.2d 29 (CA5 1967) (construction of insurance policy; "no room for doubt as to the required result," *id.*, 30); *Hamilton* v. *Maryland Cas. Co.*, 368 F.2d 768 (CA5 1966) ("[T]he question here is the simple one of whether the insurance policy says what it means and means what it says." *id.*, 769); *Weitzner* v. *United States*, 309 F.2d 45 (CA5 1962), *cert. denied*, 372 U.S. 913 (1963) ("It has long been settled that the homestead provisions of the Florida Constitution do not create property rights in the husband, wife or children," *id.*, 48).

case like this one involving an issue of significant public policy which is bound to recur (see Pet. 30-33). *Trail Builders Supply Co.* v. *Reagan,* 409 F.2d 1059 (CA5 1969), cited by respondents (R. Br. 11), so states:

> "We are convinced that [certification] would be the best way to dispose of the present case since we have no guidelines under existing Florida jurisprudence to assist us in making a determination, and since our interpretation of the exclusive remedy provision of the Florida Workmen's Compensation Act would have a significant state-wide impact." *Id.* 1061.

A plain conflict exists, and this Court is called upon to resolve it.

The Erroneous Judgment on the Merits

Respondents fail to discuss the fundamental issue of public policy raised in this case: Does a Florida corporation have an equitable right to profits that it could not rightfully make? Only New York has chosen to create such an extraordinary right, holding in the unique case of *Diamond* v. *Oreamuno,* 24 N.Y.2d 494, 248 N.E.2d 910 (1969), that profits wrongfully made on inside information are a legitimate "corporate opportunity." No other state has followed that rule. The decision below, adopting an extreme minority rule as "the law of Florida," is wholly without support, and we take respondents' silence as a concession of the point.

The ruling also invents a new class of fiduciaries, in an effort to extract a windfall recovery. *Quinn* v. *Phipps,* 93 Fla. 805, 113 So. 419 (1927), does not support the decision below, contrary to respondents' contentions (R. Br. 19-20) and the view of the majority below (21A). *Quinn* is a perfectly conventional case about abuse of a confidential relationship by someone who was actually put in a position of trust. It does not hold that *any* person who by some means

acquires "confidential information which is 'owned' by someone else" (R. Br. 20; 21A) automatically becomes accountable as a "fiduciary" to its source, however remote.

The majority below neglected its duty under *Erie* and refused to employ the useful and enlightened Florida certification procedure, which would have equipped it with an authoritative and binding statement of the applicable standards. Instead it reached an extraordinary result wholly without the support of Florida precedents. Petitioner has thus been denied the opportunity to have its duties determined in accordance with Florida law.

CONCLUSION

For the reasons set forth above and in the Petition, the writ of certiorari should be granted and the judgment of the Court of Appeals for the Second Circuit reversed.

Respectfully submitted,

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October 24, 1973

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-495

INVESTORS DIVERSIFIED SERVICES, INC., INVESTORS VARIABLE PAYMENT FUND, INC., and IDS NEW DIMENSIONS FUND, INC.,
Petitioners,

v.

JACOB SCHEIN and MARVIN H. SCHEIN,
Respondents.

INVESTORS DIVERSIFIED SERVICES, INC.,
Petitioner,

v.

ANTONE F. GREGORIO
Respondent.

PETITIONERS' REPLY TO RESPONDENTS' BRIEF IN OPPOSITION

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October 31, 1973

IN THE

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OCTOBER TERM, 1973

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Respondents.

INVESTORS DIVERSIFIED SERVICES, INC.,
Petitioner,

v.

ANTONE F. GREGORIO
Respondent.

PETITIONERS' REPLY TO RESPONDENTS' BRIEF IN OPPOSITION

Petitioners, Investors Diversified Services, Inc., Investors Variable Payment Fund, Inc., and IDS New Dimensions Fund, Inc., respectfully submit this brief in reply to contentions made in the brief of respondents Schein and Gregorio in opposition to the grant to the writ of certiorari in this case.

The Extraordinary Nature Of The Decision Below

Respondents have strangely postponed to the final pages of their brief (R. Br. 17-21) any treatment of the question which must be the starting point for considering petitioners' application for review by this court: What was the nature of the decision below and by what judicial process was it reached? For it is the utter failure of that decisional

process to conform to the constitutionally-mandated dictates of *Erie R.R. Co.* v. *Tompkins,* 304 U.S. 64 (1938) from which the necessity derives either for a reversal on the merits or resort to the Florida certification procedure.

Respondents' discussion of the decision below fails to confront, or even mention, its most notable feature, that it announces as the common law of Florida a proposition unknown to the law of that or any other jurisdiction, namely, the right of a corporation to a windfall recovery of profits made by "tippees" who, having no relationship whatever to the corporation, trade on the basis of information remotely obtained from that corporation. Nor do respondents make the least attempt to analyze *Diamond* v. *Oreamuno,* 24 N.Y.2d 494, 248 N.E.2d 910, 310 N.Y.S.2d 78, (1969) or to contest petitioners' argument (Pet. Br. 9-10) that in "stretching" *Diamond* the court below abandoned its rationale.

It therefore cannot be gainsaid, we submit, that the court below undertook to create out of whole cloth a new rule of law. The question next arises, what can be found in the jurisprudence of Florida to justify such judicial legislation? Respondents have supplied no answer of their own but have contented themselves with reciting portions of the majority opinion in which the court below described the procedures it followed. Thus little needs to be added to petitioners' analysis of those procedures (Pet. Br. 7-9) except to note again that the only Florida case relied on, *Quinn* v. *Phipps,* 93 Fla. 805, 113 So. 419 (1927), involved no more than a run-of-the-mill breach of the fiduciary duty owed by an agent to his principal and that nothing in "the body of law of other jurisdictions" had any bearing on the result reached. Particularly inapplicable were the cases dealing with the liability of "co-venturers" and of one "who knowingly participates in or joins in an enterprise whereby a

violation of a fiduciary obligation is effected" (R. Br. 19) when nothing in the complaint remotely suggests that there was any joint venture or common enterprise between petitioners and Chasén, the chief executive officer of Lums (See Repondents' Statement Of The Case, R. Br. 3-5).

Since the court below struck out on its own along a path never trodden before, it is captious of respondents to charge petitioners with failing to cite Florida cases *contra* to the decision below, for cases relevant to a totally new departure simply do not exist. What has occurred here is thus entirely different from the typical case in which a determination of State law is to be made for which there is no controlling precedent. Typically, these involve the construction of a statute or the decision of issues for which precedents, one way or the other, may be found in some number. Contrast, for example, the procedures followed by the court below in this case with those followed by the Court of Appeals for the Tenth Circuit in *W.S. Ranch Co.* v. *Kaiser Steel Corp.*, 388 F.2d 257 (10th Cir. 1967), rev'd. 391 U.S. 593 (1968). There the court undertook a most careful scrutiny of the principal New Mexico decisions in the area dealing with the law of water rights and eminent domain and based its decision upon an analysis of those State law precedents. Id. at 258-60. Even so, the Supreme Court deemed that the Court of Appeals should have abstained from attempting to predict the law of New Mexico.

Consequently, those cases cited by respondents (R. Br. 21) as militating against a grant of certiorari here do not meet the situation presented by the extraordinary decision below. It is by no means petitioners' position merely that the court below wrongly decided a question of local law, or decided it in a way in conflict with applicable local decisions or attempted to substitute its judgment for that of controlling State authorities; our position is that the court

below has charted a new course of its own without any warrant whatsoever in the law of Florida.

It is this unique aspect of the decision below which, petitioners submit, calls either for reversal on the merits or the submission of the question to the Supreme Court of Florida.

The Right to Certification

Respondents place their principal reliance on the contention that petitioners may not now seek certification because they did not seek or suggest it upon the appeal from the decision of the District Court (R. Br. 10-17). This contention is without merit.

First, it may be said that petitioners had no reason to foresee that the Court of Appeals would depart from *Erie,* as we submit that it has. On their petition for rehearing with a suggestion for rehearing *in banc,* petititioners did suggest utilization of the Florida certified question statute to obviate any difficulties the court below might have in dealing with Florida law. Moreover, Judge Kaufmann's dissent makes it clear that Florida certification was considered by the court and that the majority did "refuse" to avail itself of it. (478 F.2d 817 at 828, Pet. Appendix at 31 A)

Secondly, the compelling need for certification, as for abstention where certification is unavailable, arises from the overriding demands of "wise judicial administration." *E.g., United Gas Pipe Line Co.* v. *Ideal Cement Co.,* 369 U.S. 134, 135 (1962). Hence both this Court and the Circuit Courts of Appeal have not hesitated in a proper case to order abstention or certification in the absence of any suggestion by the parties. *United Gas Pipe Line Co.* v. *Ideal Cement Co., supra; Clay* v. *Sun Insurance Office,* 363 U.S.

207 (1960); *Railroad Commission* v. *Pullman Co.*, 312 U.S. 496 (1941); *Aldrich* v. *Aldrich*, 375 U.S. 249 (1963). In *Kaiser Steel* v. *W.S. Ranch Co.*, 391 U.S. 593 (1968), a diversity case involving only the question of the correct interpretation of State law under *Erie*, the Supreme Court granted a motion for abstention pending the decision of a declaratory judgment action in the New Mexico State court, although Kaiser Steel filed its declaratory action and moved for abstention only after an adverse decision by the Court of Appeals. *W.S. Ranch Co.* v. *Kaiser Steel Corp.*, *supra* at 262, 265-66.*

Petitioners submit, therefore, that they have sufficiently raised the question of certification, under applicable precedents, to justify the grant of their petition for a writ of certiorari if such a grant is otherwise warranted on the merits.

The paramount question presented by this petition is that of the proper limitations under our Federal-State system of government upon the power of the Federal courts to declare State law. Rather than to overstep those limitations, as it did by creating a novel right of corporate recovery, it was incumbent on the court below to obtain an authoritative determination from the Florida Supreme Court of the important question of Florida law it was called upon to decide.

---

* Judge John R. Brown in his concurring and dissenting opinion dissented from the refusal of the majority to abstain even though he concurred without reservations in overruling the petition for rehearing since, with the materials on hand, "the conclusion reached certainly appears to be a permissible and probably the correct one." *Id.* at 262.

CONCLUSION

For these reasons and those stated in the Petition the writ of certiorari should be granted.

Respectfully submitted,

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October 31, 1973

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SUPREME COURT, U. S.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-439

LEHMAN BROTHERS,

Petitioner,

v.

JACOB SCHEIN; MARVIN H. SCHEIN; ANTONE F. GREGORIO; LUM'S INC.; MELVIN CHASEN; BENJAMIN SIMON; INVESTORS DIVERSIFIED SERVICES, INC.; INVESTORS VARIABLE PAYMENT FUND INC.; IDS NEW DIMENSIONS FUND, INC.; EUGENE S. SIT; and JAMES R. JUNDT,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONER LEHMAN BROTHERS

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-439

LEHMAN BROTHERS,

Petitioner,

v.

JACOB SCHEIN, *et al.*,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONER LEHMAN BROTHERS

Opinions Below

The majority and dissenting opinions of the Court of Appeals, rendered on May 10, 1973, are reported at 478 F.2d 817 (61a)[1]. The opinion of the District Court, which was reversed by the Court of Appeals, is reported at 335 F. Supp. 329 (50a).

1. Citations with the suffix "a" are to the Single Appendix of the Record, prepared in connection with this matter and Nos. 73-440 and 73-495.

Jurisdiction

The judgment of the Court of Appeals was entered on May 10, 1973, and a timely petition for rehearing, filed by the petitioner herein, was denied by the Court of Appeals on June 8, 1973 (85a). The petition herein was filed on September 6, 1973. On December 3, 1973 this Court granted the writ of certiorari, limited to the following question:

> "Did the Court of Appeals for the Second Circuit err in not certifying the question of Florida law to the Florida Supreme Court pursuant to Florida's certification procedure? Fla. Stat. Ann. Sec. 25.032 (1961), Fla. App. Rules, R. 4.61 (1967)."

The jurisdiction of the Court is invoked under 28 U.S.C. §1254(1).

Question Presented

In this diversity action brought in the Southern District of New York, but governed by Florida law, should the Court of Appeals have certified the decisive issue of law to the Supreme Court of Florida, pursuant to Florida's statutory certification procedure, to permit the Supreme Court of Florida to decide whether a novel rule of public policy would become the law of Florida, in a situation where Florida's interests are vital and paramount?

Statutes Involved

Florida law, FLA. STAT. ANN. §25.031 (1961), provides that

> "The supreme court of this state may, by rule of court, provide that, when it shall appear to the supreme court of the United States, to any circuit

> court of appeals of the United States, or to the court of appeals of the District of Columbia, that there are involved in any proceeding before it questions or propositions of the laws of this state, which are determinative of the said cause, and there are no clear controlling precedents in the decisions of the supreme court of this state, such federal appellate court may certify such questions or propositions of the laws of this state to the supreme court of this state for instructions concerning such questions or propositions of state law, which certificate the supreme court of this state, by written opinion, may answer."

In addition the Supreme Court of Florida is enabled by statute to effectuate §25.031 by rulemaking, FLA. STAT. ANN. §25.032 (1961):

> "The supreme court of this state is hereby authorized and empowered to collaborate with any and all other courts of last resort, of other states and of the United States, in the preparation and approval of uniform rules of court to make effective this and similar laws."

Pursuant to §25.032, the Supreme Court of Florida promulgated FLA. APP. RULES, R. 4.61 (1967):

> RULE 4.61. Certified Questions from Federal Courts
>
> a. When Certified. When it shall appear to the Supreme Court of the United States, or to any of the Courts of Appeal of the United States that there are involved in any proceeding before it questions or propositions of law of this state which are determinative of said cause and that there are no clear controlling precedents in the decisions of the Supreme Court of this state, such federal appellate court may

certify such questions or propositions of law of this state to the Supreme Court of Florida for instructions concerning such questions or propositions of state law.

b. Jurisdiction. Questions or propositions of law referred to in sub-paragraph a hereof shall be certified for answer to the Supreme Court of this state.

c. Method of Invoking Rule. The provisions of this rule may be invoked by any of the federal courts referred to in sub-paragraph a hereof upon its own motion or upon the suggestion or motion of any interested party when approved by such federal court.

d. Contents of Certificate. The certificate provided for herein shall contain the style of the case, a statement of facts showing the nature of the cause and the circumstances out of which the questions or propositions of law arise and the question of law to be answered.

e. Preparation of Certificate. The certificate may be prepared by stipulation or as directed by such federal court. When prepared and signed by the presiding judge of said federal court, it shall be certified to the Supreme Court by the Clerk of the federal court and under its official seal. The Supreme Court may, in its discretion, require the original or copies of all or any portion of the record before the federal court to be filed with said certificate where, in its opinion, such record may be necessary in the determination of said cause.

f. Costs of Certificate. The costs of the certificate and filing fee shall be equally divided between the parties unless otherwise ordered by this Court.

g. Briefs and Argument. The appellant or moving party in the federal court shall file and serve upon its adversary its brief on the question certified within 30 days after the filing of said certificate in

the appellate court of this state having jurisdiction. The appellee or responding party in the federal court shall file and serve upon its adversary its brief within 20 days after the receipt of appellant's or moving party's brief and a reply brief shall be filed within 10 days thereafter.

h. Oral Argument. Oral argument may be granted upon application and, unless for good cause shown the time be enlarged by special order of the Court prior to the hearing thereon, the parties shall be allowed the same time as in other causes on the merits.

Statement of the Case

The district court had jurisdiction of this matter solely on the basis of diversity of citizenship, 28 U.S.C. §1332(a)(1). Three similar shareholder's derivative suits[2] were filed in the Southern District of New York[3] naming Lehman Brothers ("Lehman") and others as defendants. These actions have been consolidated throughout and are so treated here.[4] Respondents Schein and Gregorio, plain-

2. *Gildenhorn* v. *Lum's, Inc.*, No. 70 Civ. 5733 (filed Dec. 29, 1970); *Gregorio* v. *Lum's, Inc.*, No. 71 Civ. 1925 (filed Jan. 12, 1971); and *Schein* v. *Chasen*, No. 71 Civ. 4218 (filed Sept. 24, 1971).

3. The *Gregorio* case was originally filed in the Northern District of Illinois but was transferred by consent.

4. Only the *Schein* and *Gregorio* cases are involved here, since an appeal in *Gildenhorn* was not pursued. The full captions of the actions, indicating the alignment of the parties, are as follows:

Jacob Schein & Marvin H. Schein, Plaintiffs,

v.

Melvin Chasen; Investors Diversified Services, Inc.; Lehman Brothers; Investors Variable Payment Fund, Inc.; Benjamin Simon; IDS New Dimensions Fund, Inc.; Eugene S. Sit; James R. Jundt; and Lum's Inc., Defendants.

Antone F. Gregorio, Plaintiff,

v.

Lum's, Inc.; Melvin Chasen; Lehman Brothers; Investors Diversified Services, Inc.; Eugene C. Sit; and James R. Jundt, Defendants.

tiffs below ("plaintiffs"), sue as shareholders of the nominal defendant, Lum's, Inc. ("Lum's"), a Florida corporation with its headquarters in Miami.

The complaints allege that on January 8, 1970 the defendant Melvin Chasen, then president of Lum's, placed a call from his office in Miami to the defendant Benjamin Simon, then a registered representative in Lehman's Chicago office, and told him about certain disappointing projections of Lum's earnings. These estimates were not then public. Allegedly Simon thereafter told an employee of the IDS defendants[5] in Minneapolis[6] about them. On the next day the IDS defendants allegedly sold 83,000 shares of Lum's common stock on the New York Stock Exchange at about $17.50 per share. Later that day the Exchange halted trading in Lum's stock, whereupon the company announced that projected second-quarter earnings would be "substantially lower" than anticipated and that first-half earnings would be about 20% below the previous year's level (18a ¶ 23; 29a ¶ 20). Lum's stock opened at $14.00 per share on the next trading day (19a ¶ 24).

The *Schein* complaint alleges that the unfavorable earnings estimates were the "property" of Lum's (17a ¶ 18), that Chasen learned of them in a fiduciary capacity (17a ¶ 16) and told the other defendants about them in violation

5. Investors Diversified Services, Inc.; Investors Variable Payment Fund, Inc.; and IDS New Dimensions Fund, Inc., respondents herein and petitioners in No. 73-495, were defendants below in the *Schein* action and are collectively referred to as "the IDS defendants." Of these parties, only Investors Diversified Services, Inc. is a defendant in the *Gregorio* action.

6. Eugene S. Sit and James R. Jundt, defendants in both the *Schein* and *Gregorio* cases, are alleged to be employees of Investors Diversified Services, Inc. Allegedly Simon told Sit about the projections, and Sit told Jundt (17a ¶ 19; 28a ¶ 17). Both Sit and Jundt were dismissed from the cases by the District Court for lack of personal jurisdiction (51a n.1). There was no appeal from this dismissal (63a n.1).

of that duty (20a ¶ 25). It states that the other defendants "aided and abetted" (*Id.*) such violation, used the estimates "for their own personal profit" (*Id.*) and "are liable to Lum's for their unlawful profits (including commissions)" and for "the damages it sustained thereby" (*Id.*). The *Gregorio* complaint alleges that the disappointing earnings projections were "an asset" of Lum's (30a ¶ 22) and that defendants "must account to Lum's Inc. for the profits realized by them" (*Id.*).

Lehman, Simon, Chasen, and the IDS defendants moved to dismiss the complaints for failure to state a claim on which relief could be granted, FRCP 12(b) (6) (33a, 38a, 41a, 45a). Affidavits of Simon, Chasen, and Mr. Herbert Lisle, a Lehman partner (36a, 44a, 48a), were presented on the motion and not excluded, FRCP 12(b). These established that the IDS defendants' sales were not made through Lehman Brothers and that neither Lehman nor Simon received any benefit from the sales. Thus it is undisputed[7], as the District Court stated, that the "broker-dealer defendants . . . did not profit by virtue of the sales" (55a).

In their brief in the District Court the plaintiffs urged that Lum's should recover "for the misappropriation of confidential information belonging to Lum's by its fiduciary (Chasen) and his tippees (the other defendants)", under the theory of *Diamond* v. *Oreamuno*, 24 N.Y. 2d 494, 248 N.E. 2d 910 (1969).[8] In *Diamond* the New York Court of

7. Plaintiffs had thirty days in which to file papers in opposition; they filed neither affidavits suggesting any factual issue, nor affidavits showing inability to present contrary evidence, FRCP 56(f). Thus there is no dispute that Lehman received no benefit in the transactions sued upon, FRCP 56(c).

8. Memorandum of Plaintiffs Jacob Schein, Marvin H. Schein, and Antone F. Gregorio in Opposition to Defendants' Motion to Dismiss for Failure to State a Claim or to Stay and to Dismiss for Want of Personal Jurisdiction 4-5 (Nov. 3, 1971) (cited herein as "Memorandum for Plaintiffs").

Appeals held that officers and directors of a corporation would be liable to the corporation in a derivative action for the profits they allegedly made by selling the company's stock based on inside information. The opinion is phrased in conventional terms of fiduciary duties, reasoning that inside information was an "asset" of the corporation which had been acquired by the insiders as fiduciaries of the company and misappropriated in violation of trust. But since under the usual rule a company can only recover from an insider who appropriates a lawful business opportunity, and since the company never had a lawful opportunity to sell stock on inside information, Diamond's holding that the company has "a higher claim to the proceeds," *id.*, 24 N.Y. 2d at 498, of wrongful market activity was a novel break from precedent. Plaintiffs argued that whether New York or Florida law applied the defendants were liable under the *Diamond* theory, claiming that "Flordia cases contain appropriately phrased holdings with respect to corporate directors' and officers' fiduciary obligations similar to those used in establishing the *Diamond* v. *Oreamuno* holding."[9]

Since none of the defendants, except Chasen, was a "fiduciary" of Lum's, plaintiffs further urged the court, in "the interests of public policy"[10], to apply the *Diamond* rule to non-fiduciaries too. In support of such policy they cited several rulings under §10(b) of the Securities Exchange Act, 15 U.S.C. §78j(b)[11].

9. Memorandum for Plaintiffs, 7-8.

10. Memorandum for Plaintiffs, 14.

11. *Levine* v. *Seilon*, 439 F.2d 328 (CA2 1970); *Kuehnert* v. *Texstar Corp.*, 412 F.2d 700 (CA5 1969); *Nathanson* v. *Weis, Voisin, Cannon, Inc.*, 325 F.Supp. 50 (SDNY 1971); *Ross* v. *Licht*, 263 F.Supp. 395 (SDNY 1967); *Investors Management Co.*, SEC Securities Exchange Act Release No. 9267 (1971); *Cady, Roberts & Co.*, 40 SEC 907 (1961).

The District Court, Hon. Harold R. Tyler, Jr., J., rejected plaintiffs' claims that New York substantive law applied. Following New York choice of law principles, as required under *Klaxon Co.* v. *Stentor Electric Manufacturing Co.*, 313 U.S. 487 (1941), it held that the law of the state of incorporation, here Florida, governed the nature of fiduciary obligations to a corporation (52a-53a). For the New York Court of Appeals expressly stated in *Diamond* itself, concerning fiduciary duties to corporations, that the

> "primary source of law in this area ever remains that of the State which created the corporation." *Diamond* v. *Oreamuno, supra,* 24 N.Y.2d at 503-04.

The same result was reached under a "grouping of contacts" choice of law theory, since the significant events occurred in Florida (53a). Moreover, under the "governmental interest" analysis recently stressed by New York courts, Florida law necessarily controls, because

> "Florida has the paramount interest in defining and enforcing fiduciary obligations owing to corporations incorporated and doing business within its borders" (53a).

Judge Tyler noted that, although the Florida Supreme Court had not ruled on the issue, several Florida appellate courts held that a shareholder's derivative complaint against a corporate fiduciary was insufficient if it failed to allege damage to the corporation (54a).

Recognizing that the *Schein* complaint contained at least a "bare allegation" of "damage" (54a) and also that the *Diamond* theory developed by New York might be pressed upon a Florida court, Judge Tyler also tested the complaints under *Diamond,* on which the plaintiffs relied. He held that even assuming Florida adopted *Diamond,* none

of the defendants in these cases would be liable. Chasen was a fiduciary, but he sold no stock and made no profits.[12] The IDS defendants might have profited, but they were not fiduciaries. And Lehman and Simon were excluded on two grounds, since they had no fiduciary relationship toward Lum's, and they made no profits (54a-55a). The District Court could not accept the plaintiffs' "more expansive view" (55a) of *Diamond*, which would hold liable non-fiduciaries like IDS and Lehman, particularly where such "outside individuals, corporations, or institutions" were already "subject to other private and governmental restraints on their behavior" (56a). The complaints were dismissed. The plaintiffs appealed.[13]

In the Second Circuit the plaintiffs no longer directly relied on *Diamond* v. *Oreamuno, supra*. Rather they conceded that Florida law governed, since Lum's is a Florida corporation.[14] They produced no Florida precedents supporting the *Diamond* theory and cited Florida cases only to show that a corporation suing a fiduciary need show no damage to it other than the appropriation of a business opportunity, and that Florida recognizes informal as well as formal fiduciary relationships.[15] They urged that the Second Circuit should assume that Florida would decide

12. The District Court was not required to decide whether Chasen, the only fiduciary in the case, might come within an expanded view of *Diamond*, since he was dismissed as improperly served (56a). His dismissal was not contested on appeal (63a n.1).

13. An appeal in the *Gildenhorn* case was noted but not pursued and accordingly was dismissed, *Gildenhorn* v. *Lum's Inc.*, No. 72-1374 (CA2 April 5, 1973).

14. Brief for Appellants Jacob Schein, Marvin H. Schein, and Antone F. Gregorio 5 n.1 (Feb. 14, 1972) (cited herein as "Brief for Appellants"); Reply Brief for Appellants Jacob Schein, Marvin H. Schein, and Antone F. Gregorio 2 (October 31, 1972) (cited herein as "Reply Brief").

15. Brief for Appellants 5-6, 8-14.

to adopt *Diamond* from New York[16] and to extend its application to coincide with tippor-tippee liability under federal law, which they discussed at length.[17]

The Court of Appeals reversed, in an opinion by Judge Waterman (61a). The court said that, "[i]deally, the federal court sitting in a diversity action applies the applicable state law as it has been enunciated by the highest court in the state" (66a). But the court found no pertinent Florida rulings, and it felt free "to turn for guidance to the body of law of other jurisdictions and particularly to that of New York where the resolution of the issues in the *Diamond* case . . . bears on the issues . . ." (*Id.*). The court proceeded from the assumption that Florida would adopt *Diamond:*

> "In doing so, our objective is to interpret *Diamond* as the Florida court would probably interpret it and to apply *Diamond,* as so interpreted, to the facts presented here" (66a-67a).

The court said the only question was "whether the *Diamond* holding should extend to reach third parties who, though not officers or directors of the injured corporation, are involved with directors in a common enterprise to misuse confidential corporate information for their own enrichment" (67a). Conceding that no such "common enterprise" between Chasen and the other defendants was actually alleged, the court said that the alleged "sequence of events" would "substantiate" (*Id.*) such an enterprise, citing antitrust cases on proof of conspiracy by evidence of "conscious parallelism." Since the court below found "nothing in the language of *Diamond*" which excluded "co-venturers" of a

16. Brief for Appellants 6-8, 10, 15-16; Reply Brief 3-4, 7-9.

17. Brief for Appellants 10-12, 15; Reply Brief 4, 6, 9-10.

fiduciary from joint and several liability, it found that all the defendants came within *Diamond* (68a).

The court went further, holding that all the defendants themselves became fiduciaries of Lum's, under Florida law, by "the acquisition of confidential information which is 'owned' by someone else" (70a).

The Court of Appeals stated that the "cleansing" and "prophylactic effect" of "*Diamond*, the law of jurisdiction in which the New York Stock Exchange is located", might be endangered if outsiders were "immunized" (69a). It stressed the "strong desirability of tightening the law of insider trading" (70a) and the particular need for a state law doctrine to impose liability where federal remedies might be impractical (69a). It noted that the principle it enforced—"as between the defendants and Lum's, there can be no doubt that it would be inequitable to permit the defendants to keep the rewards of the fraud" (70a) had been applied in an SEC action under the federal securities laws, where the corporation was ordered to receive and hold illegal profits, subject to the claims of injured parties[18], and observed that decisions under the Securities Exchange Act had developed the concepts of "tippor" and "tippee" liability, which were analogous to the principle under which Lehman and Simon were accountable as "participants" (71a, 72a n.8).

Defendants had pointed out that a corporate recovery might expose them to double liability, since purchasers of

18. The court cited both *SEC* v. *Texas Gulf Sulphur Co.*, 446 F.2d 1301 (CA 2), *cert. denied*, 404 U.S. 1005 (1971) and *SEC* v. *Golconda Mining Co.*, 327 F.Supp. 257 SDNY 1971), but *Golconda* is a miscitation, since it did not permit a corporate recovery; rather the funds were paid into the registry of the court.

the stock had also sued them.[19] The court dismissed this argument, saying that since the defendants were "fully aware" of such suits, they were "well able to protect themselves from multiple liability" (73a). Thus the "Florida law", as conceived by the court below, gives a Florida corporation a recovery of insiders' trading profits only if those with whom its fiduciaries deal do not recover, and it permits injured parties to appropriate for their personal benefit the value of the corporate "asset" which a fiduciary "misappropriated". The court cited no Florida cases for this principle.[20]

Judge Kaufman dissented (73a). He emphasized that those who trade on inside information deserve "universal condemnation" (*Id.*) but protested that in responding to that sentiment his brethren had invented a "totally new concept of law" that was wholly without precedent even under the law of New York (74a). He pointed out that the foundation of the majority's theory, a fiduciary duty running to the corporation, did not exist here:

> "The complaints here are barren of any allegation that the appellees—or Sit or Jundt—occupied any

19. The court noted that a private suit by an alleged purchaser of Lum's stock, *Sanders* v. *Lum's, Inc.*, 70 Civ. 5331 (SDNY), and an agency action, *SEC* v. *Lum's, Inc.*, 70 Civ. 5280 (SDNY), had been brought (72a). The *Sanders* case is still pending. The SEC action was tried in April and May of 1973. The District Court ruled in that case that Lehman Brothers did not violate the Securities Exchange Act and dismissed the complaint against Lehman, *SEC* v. *Lum's, Inc.*, CCH FED. SEC. L. REP. ¶94,134 (SDNY Sept. 13, 1973). No appeal was taken.

20. The court cited the decision under the Securities Exchange Act which developed the concept of a conditional corporate recovery. *SEC* v. *Texas Gulf Sulphur Co.*, 312 F.Supp. 77, 93 (SDNY 1970), *aff'd in part, rev'd in part* 446 F.2d 1301 (CA2), *cert. denied*, 404 U.S. 1005 (1971).

> position, such as officer, director, employee, or agent, which would create fiduciary obligations to Lum's" (76a-77a).

He contrasted the case with decisions, which the majority employed as authority, involving defendants who had positions involving responsibilities toward the plaintiff:

> "*Compare Brophy* v. *Cities Service Co.*, 31 Del. Ch. 241, 70 A.2d 5 (1949); *Quinn* v. *Phipps*, 93 Fla. 805, 113 So. 419 (1927). Liability in *Diamond* was predicated entirely on such a relationship, and in its absence, the *Diamond* rationale for liability ceases to exist" (77a).

The majority, he said, tried to "bridge this fatal gap" (*id.*) by using a "common enterprise" notion, which was not alleged in the complaints and seemed wholly "fictional" (*id.*). Rather the complaints, generously read, disclosed "nothing more than a seemingly unsolicited and haphazard revelation of certain information" (*id.*). The joint venture and aiding and abetting concepts were unavailable, since

> "there is not a word in the complaint charging that the appellees actively solicited the disclosure or that they had concocted a prearranged scheme with Chasen. We are dealing here with an isolated transaction" (78a) (footnote omitted).

The idea that *all* the defendants were "fiduciaries" had no basis either, in Judge Kaufman's view. Although federal cases expanding the liability of "tippee" traders appropriately enforced an individual's duty owed to persons with whom he traded, such cases could not be used to answer the wholly different question whether

> "*under state common law,* tippee trading is a breach of a fiduciary duty owed to the corporation whose

> shares are traded, and if so, whether such a breach is remediable through use of a shareholders' derivative action" (79a) (italics original).

The idea that a "tippee" is a state-law "fiduciary" seemed to Judge Kaufman "an unknown and untenable legal concept" (*Id.*), supported neither by agency principles nor by fiduciary principles, even as altered by *Diamond.*

Underlying the majority's error, Judge Kaufman recognized, was the assumption that Florida would adopt *Diamond,* "itself a significant alteration of the common law principles applicable to an officer's or director's trading in his corporation's shares" (79a-80a):

> "Yet because there are no pertinent Florida decisions, the majority focuses on a New York decision, *Diamond* v. *Oreamuno, supra.* Thus, liability is founded on the conclusion of two federal judges that the Florida Supreme Court, if the instant case was before it, would look to a New York decision and, in addition, would give an unprecedented expansive reading to that case" (79a).

Because he was convinced that the majority had exceeded "its authority by substituting its own view of what state law ought to be, for what the state law actually is" (80a), Judge Kaufman concluded that there was only one way to deal justly with the case. He urged the majority to use the "enlightened" (*Id.*) Florida certification procedure, which authorizes the Supreme Court of Florida to answer, by written opinion, questions of Florida law certified to it by federal appellate courts. He noted that the procedure was used by this Court and by the Fifth Circuit, and he could not comprehend why the majority had refused to do so

here (80a). If the Second Circuit certified the issue, he said,

> "The uncertainty inherent in the majority's speculation over what the Florida courts would decide if faced with this novel question of tippee liability under state common law fiduciary principles in a stockholders' derivative action would be dispelled authoritatively and finally" (81a).

Lehman moved for rehearing, pointing out that *Diamond* v. *Oreamuno, supra,* was an extreme minority position, if not a unique one, and that the majority had erred in assuming that Florida would both adopt it and expand it. Lehman specifically requested that the Second Circuit certify the question to the Supreme Court of Florida for authoritative resolution by it pursuant to the statutory certification procedure, FLA. STAT. ANN. §§25.031-25.032 (1961); FLA. APP. RULES, R. 4.61 (1967).[21] The petition was denied (85a).

Summary of Argument

Well-established doctrines of abstention fix the boundaries of the jurisdiction of the federal courts. The early dictum that "to decline the exercise of jurisdiction which is given" would be "treason to the Constitution," *Cohens* v. *Virginia,* 19 U. S. (6 Wheat.) 264, 404 (1821), has been proved too rigid in practice.[22] Rather, federal courts define their functions with an eye to "the appropriate relationship between federal and state authorities functioning as a har-

21. Suggestion for Rehearing in Banc by Appellee Lehman Brothers, at 9-10 (May 24, 1973).

22. Indeed, Professor Wright states that "[i]t is probably true that there never was such a rule, uniformly applied, in federal courts." Wright, *The Abstention Doctrine Reconsidered,* 37 TEXAS L. REV. 815 (1959).

monious whole", *Chicago* v. *Fieldcrest Dairies, Inc.*, 316 U.S. 168, 172-73 (1942), and will abstain from decision in order to avoid unnecessary disruption within the federal system:

> "Reflected among the concerns which have traditionally counseled a federal court to stay its hand are the desirability of avoiding unseemly conflict between two sovereignties, the unnecessary impairment of state functions, and the premature determination of constitutional questions." *Martin* v. *Creasy*, 360 U.S. 219, 224 (1959).

Accordingly, this Court has repeatedly declared that it is the duty of federal courts to abstain from exercising their jurisdiction rather than to formulate important new principles of public policy in areas subject to state regulation. See, *e.g.*, *Kaiser Steel Corp.* v. *W. S. Ranch Co.*, 391 U.S. 593 (1968); *Louisiana Power & Light Co.* v. *City of Thibodaux*, 360 U.S. 25 (1959); *Burford* v. *Sun Oil Co.*, 319 U.S. (1943).

Instead of abstaining here, the majority took the bit in its teeth and forged a radical new framework of regulation for Florida corporations based on its own notions of good public policy. It enacted as "the law of Florida" a new rule whereby the profits of insider trading are forfeited to the company whose shares were traded. Although this rule purports to enforce "fiduciary" duties, it in no way protects the corporation from loss, since it awards it a windfall recovery of profits which it could not legally make. This recovery is in no sense compensatory, and indeed the corporation may one day have to give it up. Rather the forfeiture has only the purpose of deterring unfairness to third persons—those with whom the insider dealt. Since this new theory fails to remedy any wrong to such persons, and indeed may make it difficult or impossible for them to recover their damages, it is the result of a basic policy

decision to emphasize deterrence at the expense of compensation. This concept has no source in Florida statutes or decisions; it was only recently conceived in New York State, in an explicit attempt to avoid the shortcomings of federal remedies by enabling any shareholder to bring a derivative suit, and has been adopted nowhere else.

Moreover the decision goes far beyond even New York's radical departure, by exposing to this novel sanction not just corporate insiders but every person who receives confidential information about a corporation, even persons who have no connection with that corporation, such as Lehman. By artificially labeling outsiders as "fiduciaries", this new rule is at war with Florida decisions. More basically, this limitless expansion of the "fiduciary" class shows that the novel penal rule has nothing to do with protecting the corporation or preserving the loyalty of corporate insiders but rather was created as a deterrent to police all market trading. It is not an extension or modification of any "fiduciary" rules; rather it is a new regulatory mechanism made up out of whole cloth. Under this Court's rulings in *Kaiser Steel Corp.* v. *W. S. Ranch Co., supra,* and *Louisiana Power & Light Co.* v. *City of Thibodaux, supra,* abstention was clearly required, to permit the courts of Florida to determine whether to adopt such a radical new principle, which broadly affects the shareholders and management of every Florida corporation.

The court below erred even more fundamentally, because the purposes of abstention could be fully achieved by a simpler, less costly procedure. The Legislature of Florida has made its Supreme Court available to answer questions concerning state law which are certified to it by federal appellate courts. In that way the crucial issues in this case could have been decided authoritatively and quickly by the Supreme Court of Florida, the body which must one day

declare the state's public policy in any event. A definitive ruling would have been secured in this case without substantial delay or expense and without limiting federal jurisdiction over any aspect of this case except the state law, which the court below was not entitled to declare. In the years since the Court first urged its use in *Clay* v. *Sun Insurance Office, Ltd.*, 363 U.S. 207 (1960), this certification procedure has been proved in practice by the Court of Appeals for the Fifth Circuit and by this Court. There is no tenable basis for the refusal to use the certification procedure, as Judge Kaufman in dissent urged the majority to do. The majority gave no reasons at all and simply ignored the point.

The refusal of the court below to employ certification demonstrates its determination in this case to act without regard to Florida law. The decision below has denied Florida the right to formulate its public policy through the organs of its own government, a right it specifically sought to preserve by adopting the certification procedure. It has created disuniformity in the application of state law, worked an injustice in this particular case and bred uncertainty and confusion as to the applicable rules. All of these undesirable consequences would have been avoided by certification.

If the federal courts are truly devoted to the fair and efficient enforcement of rights and duties as they are defined by state courts, and if the national judicial system is to develop along modern lines to that end, the decision below cannot stand.

ARGUMENT

POINT I

The decision below imposes a new regulatory framework upon trading in the stock of Florida corporations.

Prior to the decision of the New York Court of Appeals in *Diamond* v. *Oreamuno, supra,* the springboard for the decision below, it was generally said that the "common law rule precludes corporate recovery of profits made by insiders on dealings in the corporation's stock." Note, 1970 WIS. L. REV. 576, 577 (1970). Indeed "no common law judicial authority existed", Note, 37 FORDHAM L. REV. 477, 478 n.8 (1969), for any such recovery by the corporation. Courts reasoned that, since a corporation has no interest in shares of its stock owned by others, it cannot claim to be injured in transactions in such shares. See Note, 18 BUFFALO L. REV. 193, 194 (1969). The only "fiduciary" duty that an insider might owe in such context, recognized by some courts, was a limited duty toward an individual with whom he dealt. See *Strong* v. *Repide,* 213 U.S. 419, 431 (1909); *Chenery Corp.* v. *SEC,* 128 F.2d 303, 307 (CADC 1942), *rev'd on other grounds,* 318 U.S. 80 (1943); cf. *Rogers* v. *Riddle,* 128 So.2d 409 (Fla. App.), *cert. denied,* 133 So.2d 645 (Fla. 1961); Note, 22 VAND L. REV. 1412, 1414-15 (1969); Note, *supra,* 18 BUFFALO L. REV. at 194.

Corporate recovery from an insider on fiduciary principles, prior to *Diamond,* required proof of loss to the corporation, for example, by the misappropriation of a cor-

porate business opportunity or asset or competition with the corporation:

> "The principle that directors are fiduciaries of their corporations is amply supported by New York case law. Its application, however, has always been in holding directors liable for making personal profits from transactions entered into or which should have been entered into on behalf of the corporation, taking advantage of corporate opportunities, diverting corporate assets, competing with the corporation, or making extra profits when selling control of the corporation. Further, in each case, where a director has been held liable to the corporation on fiduciary grounds, there existed damage to the corporation. . . ." Note, *supra,* 37 FORDHAM L. REV. at 478-79 (footnotes omitted).

Thus, prior to *Diamond,* no New York decision "held directors accountable to their corporation for profits made *unless* the corporation sustained some loss or harm by the director's action." Note, *supra,* 18 BUFFALO L. REV. at 197 (italics original); see also Note 45 NOTRE DAME LAW, 314, 319, 321 (1970). This was the ordinary rule with respect to stock transactions in particular:

> "But a director or officer does not ordinarily violate his fiduciary duty to the corporation by dealing in its stock, unless the corporation is thereby harmed. Accordingly, insider accountability has been limited to purchases which usurped a corporate opportunity and sales which improperly effected a transfer of corporate control." Note, 55 VA. L. REV. 1520, 1522-23 (1969) (footnotes omitted).

Moreover, while a director had a duty not to appropriate corporate assets, see, *e.g., Marcus* v. *Otis,* 168 F.2d 649

(CA2), *modified,* 169 F.2d 148 (1948), his use of corporate information alone was not viewed as such a misappropriation if he did not also appropriate a business opportunity:

> "None of these [prior New York] cases support the proposition that the use of inside information is per se a breach of fiduciary duty. Rather, they hold that the particular manner in which the information is used gives rise to the breach of fiduciary duty, such as where use of the information amounts to a usurpation of a corporate opportunity or results in competition with the corporation." Note, *A Comparison of Insider Liability Under Diamond* v. *Oreamuno and Federal Securities Law,* 11 B. C. IND. & COM. L. REV. 499, 502-03 (1970).

In other words, taken alone, "[i]nside information, however, has generally not been considered an asset of the corporation", Note, *supra,* 37 FORDHAM L. REV. at 480. This rule may be contrasted with the stricter standards imposed on conventional trustees outside the corporate context. Compare *Mosser* v. *Darrow,* 341 U.S. 267, 271 (1951); see Note, *Diamond* v. *Oreamuno: A Fresh Approach to Insider Trading and the Duties of the Corporate Fiduciary,* 31 U. PITT. L. REV. 296, 298 (1969); Note, *supra,* 1970 WIS. L. REV. at 580.

Recovery on a "corporate opportunity" theory rests on the premise that the opportunity would have been of value to the corporation, see Note, *supra,* 1970 WIS. L. REV. at 581. A corporation, however, could not legally sell its own stock on inside information or retain the profits of such a transaction. Therefore, it sustains no loss when an insider does so for his own account, and there is no logical basis for a corporate recovery of his profits:

> "It would have been illegal under federal securities law for the corporation to sell its shares on the basis of the inside information. Thus, the defendants' actions can not be construed as diverting a corporate opportunity or competing with the corporation since

> the corporation itself was prohibited from engaging in the transaction." Note, *supra,* 11 B. C. IND. & COM. L. REV. at 503.

It is specifically held in proceedings to enforce Rule 10b-5 against persons who sold stock on inside information for the account of others that the "obligations of a fiduciary do not include performing an illegal act," *Investors Management Co., Inc.,* SEC Securities Exchange Act Release No. 9267, at 14 (July 29, 1971); see also *Cady, Roberts & Co.,* 40 S.E.C. 907, 916 (1961). Compare *Mosser* v. *Darrow, supra; Norte & Co.* v. *Huffines,* 304 F. Supp. 1066, 1109 (SDNY 1968), *aff'd in pertinent part,* 416 F.2d 1189 (CA2 1969), *cert. denied,* 397 U.S. 989 (1970); *Brophy* v. *Cities Service Co.,* 31 Del. Ch. 241, 70 A.2d 5 (1949) (fiduciaries competing with principal's wholly lawful plan to purchase corporate securities); see also Note, *supra,* 55 VA. L. REV. at 1525; Note, *supra,* 37 FORDHAM L. REV. at 479-480.

Florida decisions specifically state that a corporation cannot recover the profits made by corporate fiduciaries in personal transactions, when such transactions do not interfere with the business of the corporation. *Doeg* v. *Thornton,* 174 So.2d 570, 573 (Fla. App. 1965); *Renpak, Inc.* v. *Oppenheimer,* 104 So.2d 642, 644 (Fla. App. 1958) . Likewise, the fiduciary duty of a director is defined as a duty not "to act in hostility to the interest of the corporation," *Etheredge* v. *Barrow,* 102 So.2d 660, 662 (Fla. App. 1958). See also Sowards, *Corporations and Corporate Finance,* 14 U. MIAMI L. REV. 575, 577 (1960) (fiduciary of Florida corporation "accountable for personal profits arising from opportunities which rightfully belong to the corporation or for profitable activities which stem from a conflict of interest"). Since insider trading usurps no corporate opportunity and involves no conflict of interest, it is not a fiduciary violation under Florida law, and the corporation has no right to recover the profits.

Florida adheres to the general rule that a suit seeking a judgment in favor of a corporation must allege that the

defendant caused some loss to the corporation. Its courts specifically so hold in shareholder's derivative cases like this one:

> "Thus, in order for a complaint to state a cause of action entitling the stockholder to relief, it must allege two distinct wrongs: the act whereby the corporation was caused to suffer damage, and a wrongful refusal by the corporation to seek redress for such act." *James Talcott, Inc.* v. *McDowell,* 148 So.2d 36, 38 (Fla. App. 1962).

This principle has been repeatedly applied. ***Palma*** v. *Zerbey,* 189 So.2d 510 (Fla. App. 1966), *cert. denied,* 200 So.2d 814 (Fla. 1967); ***Maronek*** v. ***Atlantis Hotel, Inc.,*** 148 So.2d 721 (Fla. App. 1963).[23]

When wrongful acts cause a direct injury to a shareholder "which is separate and distinct from that sustained by other shareholders," the remedy is an individual suit. *Citizens National Bank* v. *Peters,* 175 So.2d 54, 56 (Fla. App. 1965). In contrast, a derivative action is proper if "the injury is primarily against the corporation, or the stockholders generally. . . ." *Id.* Since making profits by insider trading causes a "separate and distinct" injury to the persons who bought stock, under Florida law a suit for such profits must be brought by those shareholders individually, and not by the corporation, which has suffered no such loss.

The court below rejected all such limitations, relying on the New York decision, *Diamond* y. *Oreamuno, supra. Diamond* held that a corporation could recover profits made

23. The court below found *Palma* "totally unpersuasive", since it "failed to provide a discussion of the issues" and was a per curiam opinion by "a lower Florida court" (72a n.9). But the issue is so well grounded in Florida law that no "discussion" was called for, and to ignore a reported appellate decision squarely violates *West* v. *American Tel. & Tel. Co.,* 311 U.S. 223 (1940), and *Six Companies of Calif.* v. *Joint Highway Dist. No. 13,* 311 U.S. 180 (1940). Moreover, *Palma* was taken to the Supreme Court of Florida, and that court denied certiorari.

by officers and directors who sold stock based on inside information, even though the corporation sustained no loss, the insiders had not deprived the corporation of any asset, and their wrongful market activity was not a business opportunity legally available to the corporation. *Diamond* is "unique in both its reasoning and conclusion," Note, *supra,* 37 FORDHAM L. REV. at 478. Since it overruled "what has apparently been accepted law in the lower courts of New York for some time," Note, *supra,* 18 BUFFALO L. REV. at 198, *Diamond* plainly was based on concerns which were theretofore irrelevant to fiduciary liability, and has a purpose entirely different from that which governed earlier cases.

Diamond is a piece of creative judicial legislation. Although couched in familiar terms of corporate fiduciary duties, it does not seek to enforce duties of loyalty to the corporation nor to compensate any wrong to the corporation. Its premise is, rather, the need to deter directors from trading based on inside information. The New York Court of Appeals in *Diamond* reviewed existing federal remedies under Rule 10b-5[24] and §16b[25] and found them "rather limited". 24 N.Y.2d at 502. Therefore, it frankly decided to create judicially a common-law rule to deter conduct prejudicial not to the corporation but to "outsiders"—buying and selling shareholders.

> "In view of the practical difficulties inherent in an action under the Federal law, the desirability of creating an effective common-law remedy is manifest." 24 N.Y.2d at 503.

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24. 17 C.F.R. §240.10b-5 (1973).

25. 15 U.S.C. §78p(b).

Practice under §16(b) had shown that "a derivative action can be an effective method for dealing with such abuses," *id.*, 500, and the New York court decided to rely upon the "private Attorney General", *id.*, 503, to administer its new enforcement tool. Thus, in contrast with the federal right of action for persons injured by insider trading, *Diamond* enables any shareholder to bring suit:

> "*Diamond's* derivative action is a somewhat better deterrent than either the federal court's solution [in *SEC* v. *Texas Gulf Sulphur Co.*, 312 F.Supp. 77 (SDNY 1970), *aff'd in part, rev'd in part* 446 F.2d 1301 (CA2), *cert. denied*, 404 U.S. 1005 (1971)] or class actions, since there are more parties—all the stockholders—who can initiate a derivative suit." Note, 83 HARV. L. REV. 1421, 1426 (1970) (footnotes omitted).

But recovery under *Diamond* does nothing for those who are actually damaged by insider trading. Thus this new right of action is in no sense a "remedy", since injured parties are not compensated, and its only purpose is to regulate insiders' conduct by its supposed deterrent effect. It is a new regulatory device, created by the New York court because it believed federal law had not then developed sufficiently to provide an effective deterrent:

> "The essence of *Diamond* is that the derivative suit is the only practicable method for regulating insider trading on the securities market. The real victims of nondisclosure are admittedly the parties with whom directors deal, but neither federal nor state law has armed buyers and sellers with a sufficiently effective private cause of action to discourage directors from exploiting their privileged position. Derivative plaintiffs must therefore be allowed to serve as 'private Attorney[s] General' if fiduciary stand-

> ards are to be faithfully observed. Allowing the uninjured corporation to recover is justified because the windfall and the substantial attorney's fees inevitably accompanying it afford an incentive for private 'prosecutions'. If the private regulatory scheme Chief Judge Fuld envisions is to work, its agents must be rewarded for their efforts." Note, *supra,* 55 VA. L. REV. at 1529-30 (footnote omitted).

The corporate recovery is pure windfall. There is a plain analogy with the liability imposed by §16(b)[26] upon officers, directors, and large shareholders who engage in short-swing trading in their company's stock, and the court in *Diamond* so noted. 24 N.Y.2d at 500.

Diamond suggests two compensatory theories for corporate recovery, but neither will support an award of the defendant's trading profits. Thus the opinion suggests that a corporation may be injured in its "good will" and "reputation", 24 N.Y.2d at 499, but it is recognized that such supposed loss has no relation to trading profits. See Note, *supra,* 11 B. C. IND. & COM. L. REV. at 514 n.80. And the idea that an insider appropriates a corporate "asset" by trading on inside information (24 N.Y.2d at 498), has been dismissed as "makeweight", Note, *supra,* 83 HARV. L. REV. at 1429, since such information has no value to the corporation. The "corporate asset theory", rather, "is a fiction, the purpose of which is to deter and punish conduct deemed undesirable by the court." Note, *supra,* 1970 WIS. L. REV. at 583; see also Note, *supra,* 83 HARV. L. REV. at 1431.

The introduction of this new deterrent device into the law of New York required a decision to sacrifice certain interests in favor of others. Commentators have remarked on the implications of such a decision.

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26. 15 U.S.C. §78p(b).

Diamond may expose a defendant to double liability. He may have to return profits to the corporation in one lawsuit, and he may be held liable to individual purchasers in another lawsuit. Some question this, since "it is difficult to interpret *Diamond* as establishing an injury distinct from that recognized by federal law," Note, *supra,* 83 HARV. L. REV. at 1431, and double liability would therefore be "penal", Note, *supra,* 55 VA. L. REV. at 1533. However, if a setoff of a prior judgment is permitted in a later suit, *Diamond* would compel "a race between the corporation and the victimized party to be first to recover the defendant's booty," Note, *supra,* 45 NOTRE DAME LAW, at 323. Others argue that double liability is fully consistent with the expressed *Diamond* theory:

> "If it is entitled to such a recovery—assuming that the *Diamond* theory is not a facade for some other purpose—then the corporation should not have to share its funds with others, however worthy their claims." Folk, *Corporation Law Developments—1969,* 56 VA. L. REV. 755, 800 (1970) (footnote omitted).

See also, Note, *supra,* 1970 WIS. L. REV. at 585. If so, *Diamond* will not only impose double liability but also will deprive many victims of insider trading of any remedy, for the corporate recovery may wipe out the defendant's assets, rendering a judgment in favor of a purchaser worthless.

Appreciating the injustice of such results, others propose that the corporation's recovery be subordinated to the claims of injured parties. Note, *supra,* 11 B. C. IND. & COM. L. REV. at 514; Note, *supra,* 31 U. PITT. L. REV. at 305. The *Diamond* court so suggests, in stating that the only issue it

decided was, "as between the corporation and the defendants, who has a higher claim to the proceeds," 24 N.Y.2d at 498, and adding that the "fund" might be "subject to a superior claim". *Id.* 504.[27] The prospect that the corporation may have to surrender its recovery makes it obvious that *Diamond* does not "remedy" any wrong to the corporation but rather awards it a conditional windfall:

> "The intimation that the corporation might have to relinquish its recovery to 10b-5 complainants contradicts the court's common law theory for allowing the derivative suit. If the corporation is the beneficiary of a trust, it should not have to share the proceeds from conversion of its property. In addition to exposing the limits of the corporate asset theory, this contradiction demonstrates that the derivative action in *Diamond* was conceived as an expedient alternative born of the inability of buyer and seller remedies to regulate fiduciary access to inside information." Note, *supra,* 55 VA. L. REV. at 1531-32.

Even if the judgment for the corporation will in theory be subordinated to individual claims, further problems arise. Although the *Diamond* court suggested that all such claims could be dealt with in a single interpleader proceeding, it conceded that the purchaser's actions are unwieldy (24 N.Y.2d at 502), and it was apparently unaware that Rule 10b-5 claims could not be tried in state courts because federal courts have exclusive jurisdiction over such claims. 15 U.S.C. §78aa. Thus even if the rights of injured parties could theoretically be protected under *Diamond,* such persons face substantial additional obstacles in securing recovery:

27. Likewise, the court below in this case implied that the defendants should not be exposed to multiple liability (73a).

> "The decision, however, will do little to soothe the troubled area of insider trading. Even if the defendants were to organize a class action against themselves, and manage to obtain jurisdiction of the class in state court, the 10b-5 claim of such third party defendants would appear to be in the wrong forum. Conversely, if the defendants do not bring the purchasers of their stock into state court, will or can the corporation be required to give up any part of its recovery in the derivative action in a later class or individual action by defrauded purchasers in federal court? There are fine questions of jurisdiction and of federal-state relations involved here. If 10b-5 can be used to redress wrongs that ought to be remedied in state courts, perhaps the derivative action can be used to redress wrongs more properly correctible by 10b-5. And if the remarkable expansion of federal securities regulation which has occurred in the past twenty years, and particularly in the last five, was necessary to fill a void in state regulation of the same subject, perhaps the void is now being doubly filled." Bradford, *Rule 10b-5: The Search for a Limiting Doctrine,* 19 BUFFALO L. REV. 205, 215 (1970) (footnote omitted).

The multiple policy problems arising from *Diamond* and its lack of serious theoretical basis have led to sharp criticism of the decision as ill-conceived judicial legislation:

> "However equitably damages might be assessed, the instant holding reflects an unfortunate exercise in judicial creativity. Rendered at a time when the scope of insider liability under existing statutes and agency rulings is at best in a state of flux, the instant decision merely offers the corporate insider greater uncertainty. The court has imposed what amounts to a penalty upon corporate insiders by finding a new common law liability to an undamaged entity for acts

> which existing law, to the extent deemed wise by legislatures, has already provided redress for those actually injured." Note, *supra,* 37 FORDHAM L. REV. at 481.

If New York State, by its legislature or judiciary, reassesses the adequacy of existing doctrines and decides to tolerate obstacles to individual recovery of damages in order to adopt a new deterrent to unfairness by insiders of New York corporations, by means of forfeiture of profits to an undamaged entity in a shareholder's derivative suit, it is fully entitled to do so. As *Diamond* says,

> "The primary source of the law in this area ever remains that of the State which created the corporation." 24 N.Y.2d at 503-04.

But undeniably *Diamond* required such a major policy change[28], such a reassessment of the values of competing interests, and a deliberate decision that shareholders of New York corporations will best be protected from unfairness by management under laws that emphasize deterrence rather than compensation.

No Florida court[29] or legislature has had the opportunity to weigh such considerations, as the New York Court of Appeals did in *Diamond,* and as Congress did in enacting the much more limited §16(b).

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28. *Diamond* has been described as one of a "series of policy-oriented laws and judicial decisions [which] wrought fundamental changes in the relative rights and duties of officers, directors and shareholders, and in the relationship of the corporation to the external world." Schoenbaum, *The Relationship Between Corporate Disclosure and Corporate Responsibility,* 40 FORDHAM L. REV. 565 (1972).

29. A large proportion of Florida's corporate law is still judge-made. See Wright, *Introduction to the Statutory Corporation Law of Florida,* 18 FLA. STAT. ANN. 51, 54 (1956).

Nor did the court below make any such analysis. Despite the novelty of the *Diamond* rule, the substantial criticisms addressed to it, and the lack of any Florida rulings indicating that such a principle might be favored, the *"Schein* court uncritically seized upon *Diamond's* enunciated fiduciary principle as its starting point." Note, 53 B.U.L. REV. 1150, 1152 (1973).

But the court below did not merely subject corporate insiders to this new deterrent, as in *Diamond* and as under §16(b). It went even further, extending liability to persons who had no fiduciary relationship to the corporation and who made no profits, by inferring a "joint venture" that was not even pleaded. To support such a theory, the court cited only antitrust cases involving conspiracies between competitors[30], but such cases are not pertinent in this different context. They concern situations presenting "strong motive for concerted action," *Interstate Circuit, Inc.* v. *United States, supra,* 222, in which competitors engaged in conduct "uniformly beneficial to [them] in protecting their common interests," *American Tobacco Co.* v. *United States, supra,* 793. This context is wholly different, for only the IDS defendants allegedly profited, the other defendants had no "common interest" in assisting IDS, and thus there is no reason to infer any agreement or "common enterprise" (67a).

30. *American Tobacco Co.* v. *United States,* 328 U.S. 781 (1946); *Interstate Circuit, Inc.* v. *United States,* 306 U.S. 208 (1939); *Norfolk Monument Co.* v. *Woodlawn Memorial Gardens, Inc.,* 394 U.S. 700 (1969). *Norfolk Monument* is not pertinent, since it only held that "the alleged conspiracy had not been conclusively disproved", *id.* 704, and thus summary judgment was inappropriate.

Most remarkably, the court below alternatively held that all of the defendants automatically became "fiduciaries" on receiving nonpublic information about Lum's, even though they had no connection with the company:

> "The confidential relationship of a fiduciary as that relationship is spelled out in Florida law extends not only to 'technical fiduciaries' but also to others who become 'fiduciaries' through the acquisition of confidential information which is 'owned' by someone else. See *Quinn* v. *Phipps,* [93 Fla. 805, 113 So. 419 (1927)], at 420-21. When the defendants received their 'tip' from Chasen, they were automatically clothed with a duty to Lum's not to use the information for their own selfish advantages." (70a).

This concept is wholly new to Florida or any other jurisdiction, and the *Quinn* case that the majority cites does not support it. In *Quinn* the court specifically noted that the defendant solicited the plaintiff's reliance and in turn was relied upon to carry out a transaction for the plaintiff.[31] *Quinn* cannot be used for the proposition that a person who is neither agent, nor employee, nor advisor, nor has any such connection with a corporation becomes a fiduciary simply by receiving nonpublic information.[32] Other Florida

31. "Quinn being a real estate broker, he by that means served notice on the public generally that its confidence was invited if interested in any transaction pertaining to that business. He not only invited Phipps along with the public generally, but solicited his confidence and patronage through McDonald, who brought them together. . . . [H]e knew at the time that Phipps for reasons personal to himself was anxious to secure the property; that he was amply able to purchase it; that he (Quinn) was under an obligation to negotiate for him (Phipps); and that Phipps was relying on him to do so." *Quinn* v. *Phipps, supra,* 113 So. at 442-23.

32. A commentator notes that "it is clear that the shareholders of Lum's reposed no confidence in appellees; likewise the latter accepted no trust from the former. The confidential information aspect of *Quinn* was secondary to the agency relationship. The *Schein* court's use of the case adds nothing concrete as authority." Note, *supra,* 53 B.U.L. REV. at 1153.

cases similarly hold that one is only accountable as a "fiduciary" if, for personal benefit, one violates an obligation undertaken to act in the interest of a principal.[33] Lum's had not engaged Lehman to act for it in any way.[34] The holding that anyone becomes a "fiduciary" by acquiring confidential information simply compounds a fiction in order to impose a windfall recovery.

This new notion goes far beyond *Diamond*[35], which concerns only officers and directors.

> "*Schein* has created, in effect, a new duty owed by outsiders to the corporation. . . . Even though the outsiders do not trade for their own accounts, they will be held jointly and severally liable to the issuer with those who do profit from the use of the information. Even remote, or ultimate, tippees owe the corporation a fiduciary duty." Note, 42 FORDHAM L. REV. 211, 224 (1973).

Thus the likely adverse consequences of *Diamond* will arise in any case alleging unfairness in the purchase or sale of securities of a Florida corporation. The court below has

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33. See, *e.g.*, *Connelly* v. *Special Road & Bridge District No. 5*, 126 So. 794, 797 (Fla. 1930) (employee, trusted to negotiate contracts, violates duty by competing with employer). *United Homes, Inc.* v. *Moss*, 154 So.2d 351, 354 (Fla. App. 1963) (corporate officer and agent conspire to defraud corporation in its purchase of property); *Prescott* v. *Kreher*, 123 So.2d 721, 726 (Fla. App. 1960) (failure to disclose to partners income earned for common benefit).

34. Indeed in the court below the plaintiffs pointed out that "Lehman Brothers was not the investment banker to Lum's and had no legitimate interest in receiving this information." Brief for Appellants 5.

35. Even under New York law a director who connives in a sale of stock on inside information by another insider has no liability where he makes no profits, for *Diamond* itself was dismissed on the pleadings against directors who, like Lehman, gained nothing in the transactions alleged, even though they approved them and took no action to preserve the supposed corporate asset from misappropriation. *Diamond* v. *Oreamuno*, 29 App. Div. 2d 285 (N.Y. App. Div. 1968), *aff'd* 24 N.Y.2d 499, 248 N.E.2d 910 (1969).

decided that in all such cases the public policy of Florida requires the encouragement of this new type of derivative lawsuit, and places a lower priority on recovery by the victims of unfairness.

The motives which tempted the court below to deal so freely with Florida law are not disguised in the opinion. Just as *Diamond* invented a new rule because "the Federal law does not yet provide a really effective remedy," 24 N.Y.2d at 503, the doctrine introduced below is a product of the "perceived need to create a cause of action to supplement the regulation of securities trading based on confidential information." Note, *supra*, 53 B. U. L. Rev, at 1154. The opinion so states:

> "Indeed, though the congressional policy is similar, in some cases where federal private and governmental Rule 10b-5 actions are impractical, 'immunized outsiders' might escape liability altogether except for the availability of this kind of action. . . . In view of the strong desirability of tightening the law of insider trading, we would be remiss indeed if we interpreted *Diamond* as narrowly as defendants would have us to interpret it" (69a-70a).

And at several points the court notes that its novel doctrine was constructed by borrowing concepts developed in federal securities law actions, such as conditional corporate recovery (70a n. 7) and tippor and tippee liability (72a n. 8), and grafting them onto the state law "fiduciary" theory (69a), which does away with the need that the plaintiff be an injured purchaser (65a n. 5).[36] It is

36. See *Haberman* v. *Murchison*, 468 F.2d 1305, 1312 (CA2 1972). Derivative and class action complaints concerning the same allegations as those made here, but brought under the federal securities laws, have been dismissed. *Margoles* v. *Lehman Brothers*, No. 70 Civ. 5355 (SDNY Oct. 22, 1971); *Gregorio* v. *Lum's, Inc.*, No. 71 Civ. 1925 (SDNY July 23, 1971).

clear from the opinion that the court below succumbed to the impulse to "tighten" the law of insider trading and in its enthusiasm to create "a new weapon with which to police trading on the stock exchanges located in New York City," Note, *supra,* 53 B.U.L. REV. at 1159, forgot that it was tampering in depth with the public policy of the State of Florida, which governs this case.

POINT II

In refusing to certify this decisive public policy issue to the Supreme Court of Florida, the court below disregarded the decisions of this Court.

A. The decisions of this Court mandated abstention.

The crucial question in this case clearly calls for a fundamental public policy choice, one which will affect numerous persons with different interests in Florida corporations. Such choice must be made by weighing the merits of such interests, with due regard for the existing framework of Florida corporate law.

This Court's decisions establish that when the state law is uncertain, and the importance of the issue suggests a special need for a correct result, federal courts must abstain from ruling so that a state court can authoritatively decide the issue. By abstaining courts serve public as well as private interests; thus they must consider the need to do so on their own motion. See *Wisconsin* v. *Constantineau,* 400 U.S. 433, 437 (1971); *United Gas Pipe Line Co.* v. *Ideal Cement Co.,* 369 U.S. 134 (1962).

Abstention is required if a state court's construction of a state statute may obviate a constitutional challenge, since such result would prevent needless federal interference with

valid state policies. See, *e.g., Lake Carriers' Association* v. *MacMullan*, 406 U.S. 498, 510-11 (1972); *Railroad Commission* v. *Pullman Co.*, 312 U.S. 496 (1941).

Other circumstances present the same prospect that federal courts, misunderstanding state policies, may needlessly interfere with their development, and such circumstances likewise call for abstention. When a federal court is asked to review the application of a regulatory scheme by a state administrative agency, it will usually deny relief, for

> "courts must not substitute their notions of expediency and fairness for those which have guided the agencies to whom the formulation and execution of policy have been entrusted." *Railroad Commission* v. *Rowan & Nichols Oil Co.*, 310 U.S. 573, 581 (1940).

This principle has equal force in a case like this one, where a federal court is asked to assume a policymaking role that properly belongs to a state court. In *Burford* v. *Sun Oil Co.*, 319 U.S. 315 (1943), this Court again rejected federal review of a state agency's order and stressed in particular the policymaking function which state law assigned to the state reviewing court. That court conducted plenary review and was authorized to propose new regulatory standards; indeed the Court suggested that it might be viewed as having "legislative" authority, *id.*, 325, over the regulated industry. When federal courts assumed that policymaking function, confusion resulted, and the development of the state's regulatory policy was impeded:

> "The very 'confusion' which the Texas legislature and Supreme Court feared might result from review by many state courts of the Railroad Commission's

> orders has resulted from the exercise of federal equity jurisdiction. . . . Delay, misunderstanding of local law, and needless federal conflict with the state policy, are the inevitable product of this double system of review. The most striking example of misunderstanding has come where the federal court has flatly disagreed with the position later taken by a state court as to state law." *Id.*, 327.

Similarly, in *Alabama Public Service Commission* v. *Southern Ry.*, 341 U.S. 341 (1951), this Court ordered abstention in a case attacking a state administrative order. As in *Burford*, the Court emphasized that state courts had been assigned an active, "supervisory", role in review of agency action. *Id.*, 347-48. This rule does not depend on the presence of any constitutional question that might be avoided by statutory construction, for *Burford* and *Alabama* primarily concerned the legality of agency orders under state law. Under these cases, therefore, when state courts have a continuing policymaking role, federal courts will not interfere:

> "The state agency and the state court were characterized in *Burford* as 'working partners,' and in *Alabama* state judicial review was called an 'integral part of the regulatory process.' Present in both opinions is the suggestion that a federal court interfering in this process prior to state review would be forced to determine state policy and thereby would obstruct the state's formulation of its own policy. In *Burford*, the Court cited numerous instances of chaos caused in the state by federal decisions misconstruing state policy." Note, *Judicial Abstention from the Exercise of Federal Jurisdiction*, 59 COLUM. L. REV. 749, 761 (1959) (footnotes omitted).

See also Note, *Abstention: An Exercise in Federalism,* 108 U. PA. L. REV. 226, 231 (1959) (abstention required under *Alabama* and *Burford* "where the decision of the federal courts would involve a determination of state domestic policy or an unnecessary interference with the action of state officials").

Acting consistently with the principle that federal courts ought not to determine sensitive issues of state policy, this Court ordered abstention in *Chicago* v. *Fieldcrest Dairies, Inc., supra,* in order to avoid " 'needless friction with state policies' " and " 'the waste of a tentative decision' " on the impact of possibly conflicting state and city legislation, *id.,* 172, quoting *Railroad Commission* v. *Pullman Co., supra,* 500. The parties were required to secure "an authoritative and controlling determination by the state tribunals," *id.,* before federal relief was available. In *Fieldcrest* the Court specifically stated that any constitutional issues seemed insubstantial and that avoidance of such issues was only an additional reason to abstain. *Id.,* 173.

An additional concern compelling abstention is the need for uniformity in the application of state law. When federal courts came to conflicting conclusions concerning the extent of interests in Illinois land which were granted by certain instruments, this Court ordered that the question be submitted to the Illinois courts lest a later state decision show that "the accident of federal jurisdiction" had led to a result "contrary to the law of the State, which in such matters is supreme." *Thompson* v. *Magnolia Petroleum Co.,* 309 U.S. 478, 484 (1940). Although *Thompson* was a bankruptcy proceeding, its principle is not limited to such cases, see 1A J. Moore, FEDERAL PRACTICE ¶0.203[2], at 2120 (2d ed. 1972), and the Court noted in

Thompson, 309 U.S. at 484n.11, that the principle compelling abstention was derived from *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938).

Subsequent cases illustrate these principles. Concern for uniformity in the application of state law and deference to the state's right to determine its own public policy compelled abstention in *Louisiana Power & Light Co.* v. *City of Thibodaux*, 360 U.S. 25 (1959). *Thibodaux* was an eminent domain proceeding under diversity jurisdiction. The question arose whether the city was authorized by statute to condemn certain land. For the federal court to decide that issue, the Court held, would risk the unequal application of an important state policy of broad applicability:

> "A Louisiana statute apparently seems to grant such a power. But that statute has never been interpreted, in respect to a situation like that before the judge, by the Louisiana courts and it would not be the first time that the authoritative tribunal has found in a statute less than meets the outsider's eye. Informed local courts may find meaning not discernible to the outsider. The consequences of allowing this to come to pass would be that this case would be the only case in which the Louisiana statute is construed as we would construe it, whereas the rights of all other litigants would be thereafter governed by a decision of the Supreme Court of Louisiana quite different from ours." *Id.*, 30.

The city pressed for a decision on the merits, but this Court reinstated the District Court's stay rather than permit a decision that would be but "a dubious and tentative forecast." *Id.*, 29.

This element of uncertainty in state law was clearly dispositive in *Thibodaux*, for on the same day the Court

ruled, in *County of Allegheny* v. *Frank Mashuda Co.*, 360 U.S. 185 (1959), that abstention was not required in a case that was very similar except that "the state law that the District Court was asked to apply [was] clear and certain." *Id.*, 196. Since the District Court would only be "applying to the facts of this case the settled state policy," *id.*, 190, it was not called upon, as in *Thibodaux* and in this case, to formulate such policy on its own. Mr. Justice Stewart's concurring opinion in *Thibodaux* makes this distinction clear:

> "This case is totally unlike *County of Allegheny* v. *Mashuda Co.;* decided today, post, p. 185, except for the coincidence that both cases involve eminent domain proceedings. In *Mashuda* the Court holds that it was error for the District Court to dismiss the complaint. The Court further holds in that case that, since the controlling state law is clear and only factual issues need be resolved, there is no occasion in the interest of justice to refrain from prompt adjudication." *Louisiana Power & Light Co.* v. *City of Thibodaux, supra,* 31 (concurring opinion).

Thus *Thibodaux's* distinguishing factor was the absence of state precedents:

> "While it may also be possible to distinguish [*Thibodaux* from *Mashuda*] on a narrow procedural ground, the far more significant difference between them consists in the differing conditions of the state law in each, and it appears likely that this 'settled' law factor was in fact controlling." Note, *supra,* 108 U. PA. L. REV. at 244 (footnote omitted).

The concern for uniformity of result in the application of state law is traceable to *Erie R.R.* v. *Tompkins,* 304 U.S. 64 (1938), and indeed the "doctrine of *Erie* may be seen

as a strong generating force of the abstention doctrine itself," Liebenthal, *A Dialogue on England: The England Case, Its Effect on the Abstention Doctrine, and Some Suggested Solutions,* 18 W. Res. L. Rev. 157, 185 (1966). Federal courts, enjoined by this Court to come to the same result as a state court would, have chosen to abstain when faced with a difficult problem of forecasting a state decision. See Note, *Abstention and Certification in Diversity Suits: "Perfection of Means and Confusion of Goals,"* 73 Yale L. J. 850, 855-58 (1964). There is clear authority for such course in *Thibodaux,* where the Court approved abstention

> "to permit an authoritative exposition of an unconstrued state statute and to prevent possible disparity between the federal version of state law and that which would be later fashioned in state court. This expansion of the abstention doctrine was a logical extension of the principle underlying *Erie* that federal courts must defer to state courts for the formulation of state law." Note, *Inter-Jurisdictional Certification: Beyond Abstention Toward Cooperative Judicial Federalism,* 111 U. Pa. L. Rev. 344, 346 (1963) (footnote omitted).

See also Lillich & Mundy, *Federal Court Certification of Doubtful State Law Questions,* 18 U.C.L.A., L.Rev. 888, 889-90 (1971); Note, *Louisiana Power & Light* v. *Thibodaux, The Abstention Doctrine Expanded,* 69 Yale L.J. 643, 651-53 (1960).

And *Thibodaux* clearly requires abstention in a case like this one, concerning an area subject to state regulation, where changes in the law will affect numerous persons, and a fundamental public policy choice must be made:

> "[Q]uestions may be deserving of state determination because they deal with an area of law which is

> undergoing significant development, or because the law of other jurisdictions is in sharp conflict, suggesting the need for a fundamental policy choice. . . . If the federal judge is convinced that the question posed to him is close to a matter of central and continuing state concern, then, he may be justified in invoking the doctrine." Note, *supra,* 73 YALE L.J. at 867.

Both *Thibodaux* and *Mashuda* are fully consistent with the holding in *Meredith* v. *Winter Haven,* 320 U.S. 228 (1943). *Meredith* was a suit brought by municipal bondholders to prevent the city which issued the bonds from retiring them without making certain deferred interest payments. There was a question whether the city had validly assumed such an obligation under state law. The District Court held it had not, following recent rulings of the Supreme Court of Florida. But the Fifth Circuit considered the question difficult, by reason of supposedly conflicting earlier decisions, and ordered dismissal. In this context this Court reversed, stating that

> "the difficulties of ascertaining what the state courts may hereafter determine the state law to be do not in themselves afford a sufficient ground for a federal court to decline to exercise its jurisdiction . . . ." *Id.,* 234.

Meredith holds only that a federal court's doubts whether controlling state decisions will stand do not support abstention. Thus it resembles *Mashuda* and does not concern a case like this one or *Thibodaux,* where no direct precedents exist:

> "The third point of difference, and perhaps the most important, between *Meredith* and *Thibodaux* is that in the former, after the suit was begun, a state

> decision apparently decided the precise issue presented to the district court, and the Fifth Circuit founded its relegation to the state tribunal on its belief that the state court might at some *future time* set aside that state decision. . . . *Thibodaux*, however, did not involve the refined element of fear that what presently was state law might be changed; rather it involved a serious question of state authority, an authoritative determination of which would control the outcome of the litigation." Gowan & Izlar, *Federal Court Abstention in Diversity of Citizenship Litigation*, 43 TEXAS L. REV. 194, 204-05 (1964) (italics original; footnotes omitted).

In *Thibodaux* there was more than supposed "confusion in state decisional law"; rather there was "a complete absence of state decisional law," Note, *Federal Abstention and its Relation to the Erie Doctrine*, 38 TEMP. L.Q. 72, 77 (1964). The difficulty of the case was not in the legal analysis required but in the policy judgments to be made, and abstention therefore was ordered.

The principle of *Thibodaux* does not depend on the nature of eminent domain proceedings, for "the view that eminent domain expropriations are 'special and peculiar' suits at law for federal abstention purposes was rejected by a majority of the Court" in *Mashuda*. Note, *supra*, 69 YALE L. J. at 650. Nor does it turn on the presence of a state agency as a party, for in *Thibodaux* that factor was put out of the case when the city whose powers were in question urged a decision by the federal court. Commentators have doubted that the extent to which a case concerns the powers of a state agency is material to the *Thibodaux* principle, since

> "it is questionable whether the city's condemnation of property involved in *Thibodaux* was any more

> closely related to local sovereignty or any more sensitive as a subject of federal-state conflict than the city's program for retiring its bonded indebtedness in *Meredith.*'' Note, *supra,* 59 COLUM. L. REV. at 764.

This Court recently emphasized the need to abstain in another diversity case, where the federal courts were asked to decide an important issue of state public policy. In *Kaiser Steel Corp.* v. *W.S. Ranch Co.,* 391 U.S. 593 (1968), the Court reversed the action of two lower courts and ordered abstention pending a state decision. No state agency was a party to the case. A landowner sued, claiming that a mining company had taken its land to lay a pipeline to carry water to its mining operations. The mining company asserted that it had the right to do so under a New Mexico statute, which gives any person the right to take land, as by eminent domain, to convey water for "beneficial uses."[37] The landowner maintained that the State constitution, which permitted only takings for "public use"[38], included agricultural uses but not private industry. The Court of Appeals found caselaw on related issues[39] but no decision on takings for access to water. It held the taking unlawful, based on the available precedents, *W.S. Ranch Co.* v. *Kaiser Steel Corp.,* 388 F.2d 257 (CA10 1967).

Thereafter the mining company filed a state declaratory judgment action and sought rehearing, asking the Court of Appeals to abstain. The majority summarily refused,

37. N.M. STAT. ANN. §75:1-3 (1953).

38. N.M. CONST. art. II, §20.

39. The Supreme Court of New Mexico had invalidated an earlier statute which authorized takings of land in aid of mining operations, on the ground that such operations were not a "public use". *Gallup American Coal Co.* v. *Gallup Southwestern Coal Co.,* 39 N.M. 344, 47 P.2d 414 (1935).

but Judge Brown dissented, urging that *Meredith* v. *Winter Haven, supra,* did not require federal courts to speculate unnecessarily on important state law issues:

> "Thus, *Meredith* v. *City of Winter Haven,* [*supra*], is not, as so often supposed, an absolute that under every and all circumstances a federal court in a diversity case has to plow through without calling on the state tribunals for aid in the divination of serious and troublesome state problems. Too much has gone on—indeed too much water has gone over the dam—for any such reading to be compelled. Putting to one side *Thibodaux,* in which the Court of Appeals was reversed for failure to abstain for state court determination in a diversity case, the Supreme Court's repeated use of the Florida *Clay* type certification procedure demonstrates that the policy reflected in *Winter Haven* is not a road block. It is simply one of the factors to be assayed." *W.S. Ranch Co.* v. *Kaiser Steel Corp., supra,* 388 F.2d at 263-64 (concurring and dissenting opinion; footnotes omitted).

Continuing, Judge Brown pointed out that the federal courts' rulings on state law were often overruled and that refusing to abstain in an important case not only was unfair to litigants but also needlessly interfered with the development of the state's public policy:

> "[R]eal injustice is done to litigants and, worse, more damage is done to the states' jurisprudence and its policies by a headstrong, resolute, inflexible determination on the part of a federal court to barge ahead in a sort of ascetic, misguided *Winter Haven* impulse, than will likely result from the slight delay occasioned by invoking state adjudication of the controlling issues. For the simple fact is that more and more, more federal courts are being overruled by more state courts on local issues upon which

> such federal courts have undertaken to read the *Erie* signs in the quest of the *Winter Haven* grail." *Id.*, 264 (footnote omitted).

Notably, he singled out the experience with Florida law as a particular example of the inaccuracy of federal "predictions":

> "And the experience in Florida demonstrates that state court reversals of Federal appellate decisions occur both in appeals of state cases and on *Clay* certification . . . to the Supreme Court of Florida, the latter with some spectacular results." *Id.*, 265 (footnotes omitted).

The results in Florida led him to the frank conclusion that

> "No amount of prescience, including that thought by some to come from a Federal Commission, enables a non-Florida Judge authoritatively to determine Florida policy." *Id.*, 265 n.15.

Judge Brown considered the argument that, having taken the land by self-help and invited a diversity suit, rather than using New Mexico's condemnation procedure, the mining company might well be admonished to accept the result of that suit, however doubtful. But he stressed again that his main concern was damage to "the State and its carefully nurtured, domestically contrived public policy". *Id.*, 266. Since the unguided federal ruling was "authoritative" only for one case, its only justification could be avoidance of delay. But the law does not normally strive for speedy but dubious results, nor does it favor the perpetuation of uncertainty in legal rules. Where the issue was bound to arise again soon, Judge Brown saw no point in such a ruling:

> "In the look back—even in the eyes of the pedagogical jurists—about the only virtue it will have is that someone did his duty in the *Winter Haven* sense. In the meantime, of course, Kaiser and Ranch know their rights. But no one else, and certainly not New Mexico, knows. Nor will they until New Mexico speaks. Why not listen?" *Id.*, 267 (footnote omitted).

This Court granted the mining company's petition for certiorari and unanimously reversed without argument, adopting the course urged by Judge Brown and ordering a stay of the case pending decision of the state law issue in the declaratory judgment action. The issue between the parties, the Court stated, "is one of vital concern in the arid State of New Mexico, where water is one of the most valuable natural resources." *Kaiser Steel Corp.* v. *W. S. Ranch Co., supra*, 391 U.S. at 594. Thus the decision would necessarily affect numerous New Mexico businesses and landowners—absent parties whose interests would only be represented by the considered judgment of the New Mexico courts. The issue, moreover, was unsettled and destined to recur. Uniformity of result, fairness to the parties, and the efficient protection of state-created rights in federal courts required abstention, so that the state courts could determine New Mexico's public policy:

> "The issue, moreover, is a truly novel one. The question will eventually have to be resolved by the New Mexico courts, and since a declaratory judgment action is actually pending there, in all likelihood that resolution will be forthcoming soon. Sound judicial administration requires that the parties in this case be given the benefit of the same rule of law which will apply to all other businesses and landowners concerned with the use of this vital state resource." *Id.*, 594.

Three Justices concurred separately in an opinion by Mr. Justice Brennan, who reaffirmed the position he took in dissent in *Thibodaux,* where he approved use of abstention to prevent needless friction with state policies, 360 U.S. at 33, and pointed out that the circumstances of the case came within *Alabama Public Service Commission* v. *Southern Ry., supra,* and *Burford* v. *Sun Oil Co., supra,* where the Court had refused to permit federal courts to undertake a pure policymaking function in deciding points of state law. The reliance on *Alabama* and *Burford* demonstrates that the principle of those decisions is not confined to review of administrative action, nor is it limited to suits involving state officials; rather it has equal force whenever a recurrent and important policy question must be decided by the state courts, as in *Kaiser* and this case.

Confirming the doubts of the dissenting circuit judge in *Kaiser Steel,* after this Court ruled, the state court decided the declaratory judgment suit, holding that the state law was exactly contrary to The Tenth Circuit's view, *Kaiser Steel Corp.* v. *W. S. Ranch Co.,* 81 N.M. 414, 467 P.2d 986 (1970). Thus a serious injustice was avoided, and the frustration of the state's public policy was prevented.

Some have suggested that this Court should defer to the lower court's exercise of discretion whether to abstain, see Wright, *supra,* 37 Texas L. Rev. at 825; Note, *supra,* 108 U. Pa. L. Rev. at 248, and that such deference explains the ruling in *Thibodaux.* In this case there has been no exercise of discretion to which the Court may defer. The court below completely failed to explain why it would not abstain or certify the issue, even when urged to do so by Judge Kaufman in dissent. Such summary action calls for no deference. *Kaiser Steel Corp.* v. *W. S. Ranch Co., supra,* so holds.

Just as in the *Kaiser* case the issue here is strictly one of Florida's public policy. Moreover, whatever rule is eventually established will affect every Florida corporation, its shareholders, and management personnel. This issue is destined to recur; indeed, the new rule announced by the court below is intended to spur litigation. *"Schein* should spawn a new breed of inside information cases," Note, *supra,* 42 FORDHAM L. REV. at 223, and such suits will necessarily affect actions to recover actual damages. The doctrine established in this case is only provisional and can stand only until Florida can speak authoritatively through its Supreme Court, yet it will establish, unless reversed, the liabilities of the parties to this case. Fairness to the parties, uniformity of result, and concern for the freedom of Florida to develop its own public policy called for abstention in this case.

B. Certification Accomplishes the Purposes of Abstention But Presents None of Its Practical Problems.

1. Certification provides a simpler solution.

The only alternatives here were not to abstain or to guess what the law of Florida was. There was a third way to determine the Florida law, simpler than either such method. The crucial issue could have been certified direct to the Supreme Court of Florida. Under this procedure the federal court states the issue of law and its factual background in a certificate to the Florida court.[40] The

40. For examples of such certificates, *see, e.g. Gordon* v. *John Deere Co.,* 451 F.2d 234, 235 (CA 5 1971); *National Educ. Ass'n* v. *Lee County Bd. of Pub. Instruction,* 448 F.2d 451, 452 (CA 5 1971); *Allen* v. *Estate of Carman,* 446 F.2d 1276, 1277 (CA 5 1971); *Boyd* v. *Bowman,* 443 F.2d 848, 850 (CA 5 1971). It is the "experience-born practice," *Allen* v. *Estate of Carman, supra,* 1277, of the Fifth Circuit to request the parties to submit a proposed agreed certificate for review by the court.

parties to the federal case brief and argue[41] the point, and the Florida court transmits its answer to the federal court. Certification of questions direct between state and federal courts is "a third method . . . for determining unresolved issues of state law." Note, *The Uniform Certification of Questions of Law Act*, 55 IOWA L. REV. 465, 470 (1969).

Interjurisdictional certification in the United States is a recent development, but the principle is not new. Since 1859 there has been a statutory procedure for certification of questions of law among British dominions, British Law Ascertainment Act of 1859, 22 & 23 Vict. c. 63; 9 *Halsbury's Statutes of England* (2d ed.) 582. In this country numerous states authorize their lower courts to certify questions to appellate courts within the same system. See Vestal, *The Certified Question of Law*, 36 IOWA L. REV. 629, 632-33 (1951). Within the federal system a district court may certify a "controlling question of law as to which there is substantial ground for difference of opinion," 28 U.S.C. §1292(b) to a court of appeals for decision. Likewise a court of appeals may certify to this Court "any question of law . . . as to which instructions are desired," 28 U.S.C. §1254(3).[42]

Certification preserves an active role for the federal court, unlike abstention, for rather than merely remitting the parties to a state court, the federal court states the legal issue to be decided and specifies its factual context:

> "[T]he federal court would not be reduced, in a diversity case, to a 'sterile monitor,' for it would

41. A sixty-day briefing schedule is fixed by rule of court, and argument may be permitted on application; FLA. APP. RULES, R.4.61(g), (h) (1967).

42. *See, e.g., United States* v. *Barnett*, 376 U.S. 681, 689-90 n. 6 (1964); Moore & Vestal, *Present and Potential Role of Certification in Federal Appellate Procedure*, 35 VA. L. REV. 1 (1949).

> be the basic instrument of the resolution of the entire case in specifying the state law question within the framework of the relevant facts and legal issues to the state's highest authority." Liebenthal, *supra*, 18 W. Res. L. Rev. at 201 (footnote omitted).

Because the federal court frames a specific question of law and retains all other parts of the case, the procedure differs in principle from abstention:

> "It would not seem . . . that the certification procedure is in effect a variation of abstention. . . The federal courts by taking advantage of a certification procedure do not abnegate their responsibility to decide a diversity case. . . .
>
> "The certification procedure is analogous to a situation in which a federal court temporarily abstains because another case between different parties involving precisely the same issues of state law is pending in the state appellate courts. Certainly this would be proper in a diversity case. . . ." Gowen & Izlar, *supra*, 43 Texas L. Rev. at 209-10 (footnote omitted).

Abstention may cause practical and jurisdictional difficulties, and the independent predictions of federal judges produce uncertainty and unfairness; certification has been developed as a solution.

2. The drawbacks of Erie-guesswork and absention.

Under this Court's decisions, federal courts faced with state law questions must "search for and apply the entire body of substantive law governing an identical action in the state courts," *Ruhlin* v. *New York Life Insurance Co.*, 304 U.S. 202, 209 (1938), and "ascertain from all the available data what the state law is and apply it," *West* v.

American Telephone and Telegraph Co., 311 U.S. 223, 237 (1940). For a federal judge, operating independently, to adhere to these standards can be extremely burdensome. Circuit Judge Wright, whose decision to abstain in *Thibodaux* was affirmed by this Court, has explained the awkwardness of the *Erie* role:

> "This awkwardness is easily demonstrated. First, the process of deciding cases under Erie is laborious, often onerously so, at least when state law on the point at issue is less than immaculately clear. Our mandate from *Erie* is to find out how the state high court would decide the issue today. In making that prediction, the federal judge exhaustively analyzes all the state court cases even remotely in point. While federal courts are not necessarily bound by lower state court rulings, or by the dicta and ancient holdings of the state high court, our practice, born of fear of federal-court law-making, is to defer to them far more generously than the state high court itself probably would." Wright, *The Federal Courts and the Nature and Quality of State Law*, 13 WAYNE L. REV. 317, 321 (1967) (footnotes omitted).

Since the task is to predict a decision rather than to make one, the federal court must sift through any materials that might influence a state court:

> "Nor is our inquiry ended simply by consulting the state cases. The *Erie* court must search out all the legal materials—law review articles, the treatises on the subject, and the cases from other jurisdictions—which might impress and influence the state high court in deciding the issue today. We should not be surprised, then, that *Erie*-opinions are laced with paragraph-long statements of the facts of conceivable precedents, and with long string citations representative of what one commentator calls the 'legal-massive' style of legal writing.

> "It has even been contended that *Erie* obliges the federal court somehow to intuit underlying themes or messages of the state's jurisprudence, and to elicit by induction from reported cases the decision-making techniques of the highest state court: for example, its implicit attitude toward *stare decisis*. Meeting these responsibilities would surely foster more accurate predictions. But they would also require the federal court to digest and master the entire corpus of state law; my fear is that we on the federal bench lack the acuity, leisure, and stamina for undertaking these intellectual ordeals." *Id.*, 321-22 (footnotes omitted).

See also Note, *Federal Interpretation of State Law—An Argument for Expanded Scope of Inquiry*, 53 MINN. L. REV. 806 (1969).

Some such efforts are justified by their results, but in *Erie* cases that can never be so. For the decision settles nothing except the immediate dispute between the parties. For other persons the law is still unclear; thus the federal ruling only prolongs legal uncertainty, risks inequity, and encourages forum shopping. Florida itself has suffered from such effects:

> "[T]he Florida-federal relationship has presented a vivid illustration of the uncertainty created by lame federal court decisions. The obvious result is an inequitable application of the law and a return to forum shopping, which *Erie* sought to avoid." Note, *Florida's Interjurisdictional Certification: A Reexamination to Promote Expanded National Use*, 22 U. FLA. L. REV. 21, 24 (1969) (footnotes omitted).

Nor can the inefficiency of such practice be ignored. The tentative federal decision forms no part of the state's body of precedents. Not until a similar suit arises in the state

system and the state courts decide it can an uncertain point be settled. See Wright, *supra*, 13 WAYNE L. REV. at 322-24. Since the federal court's effort achieves so little, it is plainly a waste of valuable judicial resources which begs for a solution.

Abstention, on the other hand, achieves uniformity of result and an authoritative precedent in the first litigated case; in addition it entails no sacrifice of the state's right to formulate its public policy through the organs of its own government. Yet there is a cost to the litigants. In certain cases a party may lose his right to have issues of law or fact determined by a federal court. See *England* v. *Louisiana State Board of Medical Examiners*, 375 U.S. 411, 416-19 (1964). The time and expense of the additional trial and appeal required under abstention may detract from the eventual result. See *Baggett* v. *Bullitt*, 377 U.S. 360, 379 (1964); *County of Allegheny* v. *Frank Mashuda Co.*, *supra*, 196.

3. Certification solves such problems.

The Florida certification procedure was "designed to alleviate the problems created by the *Erie* decision and abstention in our federal system." Note, *supra*, 22 U.FLA. L. REV. at 27 (footnote omitted). A Florida writer states that the certification statute may be viewed as the state's response to the apparent restrictions which this Court placed on the availability of abstention in *Meredith* v. *Winter Haven*, *supra*:

> "The enabling act was probably a reaction to the decision of the United States Supreme Court in *Meredith* v. *Winter Haven*, where the Court noted the evils of abstention and refused to abstain, deciding an issue of municipal powers in Florida without the benefit of a Florida pronouncement of the law." *Id.*, 27-28 (footnote omitted).

In enacting a certification statute, Florida's Legislature affirmatively declared its desire to have the Supreme Court of Florida resolve state law problems, even those arising under federal jurisdiction. Such an expressed state policy is due special weight in determining whether a matter should be referred to the state courts. *Alabama Public Service Commission* v. *Southern Ry., supra,* 348; *Burford* v. *Sun Oil Co., supra,* 325-27.

Since Florida adopted certification, the federal and state court systems no longer operate in watertight compartments. In fact, the system truly enables a federal district judge to act as just another court of the state, "for he will know his decision is subject to review in the highest state court through use of the certification procedure by the appellate court." Liebenthal, *supra,* 18 W. Res. L. Rev. at 205.

Certification will enable a federal district judge to play a more active role in the development of the state's jurisprudence, for he need not fear that his ruling will produce disuniformity in state law or interfere with policies that the state supreme court seeks to promote. Moreover, through certification, federal cases will contribute to the state's body of precedents and thus advance rather than retard the development of state law.

If certification is available, the court of appeals is not required to undertake an extensive investigation for binding precedents, in an effort conscientiously to comply with *Erie*:

> "In the Diogenes-like search for 'state law', the federal courts have resorted to the decisions of interappellate courts and even the decisions of the nisi prius courts. Quite obviously such decisions

> may be questionable, ill-considered and possibly may not represent the 'state law.' The solution offered by the Florida legislation would obviate resorting to unauthoritative sources to determine the law of a state, and would solve the problem of the search for controlling precedents when none, in fact, exists." Vestal, *supra*, 36 IOWA L. REV. at 644-45 (footnotes omitted).

The availability of such review will conclusively eliminate the inequities which *Erie R.R.* v. *Tompkins*, *supra*, sought to prevent. Professor Kurland states that certification offers the "greatest promise" of insuring that litigants receive their *Erie* right to equal application of state law:

> "The fourth possibility, offering the greatest promise, is to have the federal intermediate appellate court certify the troublesome question of state law to the state high court for resolution. . . . In this manner, the court best equipped to answer the state law questions could do so in a definitive manner, without the expense of time and resources demanded by a stay of the federal court proceeding pending a declaratory judgment action in the state court. . . . [T]he equality of treatment which the *Erie* rule was aimed to accomplish would be better assured." Kurland, *Mr. Justice Frankfurter, The Supreme Court and the Erie Doctrine in Diversity Cases*, 67 YALE L.J. 187, 214 (1957) (footnote omitted).

See also Note, *Consequences of Abstention by a Federal Court*, 73 HARV. L. REV. 1358, 1368 (1960).

In addition, once the state court determines the issue of state law, the court of appeals and this Court will not be confronted with that issue on appeal or certiorari. "No appeal based solely on the inaccuracy of the federal court's determination of state law is then possible, since the state's binding answer is incorporated into the federal court's decision." Note, *The Uniform Certification of Questions of Law Act,* 55 IOWA L. REV. 465, 472 (1969). At every level there is a clear gain for the efficient administration of justice.

Certification also answers any objections to the abstention doctrine. The Florida procedure has been described as "[p]robably the best solution to the delay problem," Kurland, *Toward a Co-operative Judicial Federalism: The Federal Court Abstention Doctrine,* 24 F.R.D. 481, 489 (1960). Under this expeditious procedure it cannot be said that litigants must undergo two lawsuits to gain relief:

> "If instead of abstaining, a federal court can certify the state law question—in its factual setting and in the context of any constitutional objections—directly to the state's highest court and under an expedited procedure, the litigants will be saved the time and expense of proceeding through the lower state court system, subject to trial and appellate court docket delays. Indeed, Mr. Justice Holmes referred to certification as 'a mode of disposing of cases in the least cumbersome and most expeditious way.'" Note, *supra,* 111 U. PA. L. REV. at 348 (footnote omitted).

It took two years and five months to secure a decision by the state supreme court in *Kaiser Steel Corp.* v. *W. S. Ranch Co., supra,* after the Tenth Circuit initially denied abstention, during which time the defendant stayed in pos-

session of the plaintiff's land as an alleged trespasser. Abstention was clearly required there, but commentators have since concluded that "[h]ad there been a certification procedure available to the court of appeals, it is extremely unlikely that it would have taken as long to get an answer from the New Mexico courts." Lillich & Mundy, *Federal Court Certification of Doubtful State Law Questions*, 18 U.C.L.A. L. Rev. 888, 909 (1971). A recent study, Note, *The Case for Certification*, 12 Wm. & Mary L. Rev. 627 (1971), bears out Florida's record of promptness in answering certified questions, which can fairly be compared with the fifteen months required to decide the appeal in this case.[43]

In any event, concern over delay can have little weight in this case, since the plaintiffs do not sue for their own benefit but only for the corporation, which has not even sued, and any recovery in its behalf would be a sheer windfall bonus.

Certification fully preserves the benefits of diversity jurisdiction. To the extent that diversity jurisdiction is still needed to guard against bias or influence in local courts, such needs are primarily met by a federal forum for trial, which is not affected under Florida's certification system. Note, *supra*, 73 Yale L.J. at 858-861; 868-69. When a federal court abstains and remits an issue for trial by state courts, the right to a federal trial of the pertinent facts is lost.

> "Remission is therefore quite different from the widely advocated procedure, which is provided by statute in one state, of certifying an issue from

43. The notice of appeal in this case was filed on February 4, 1972. The record was docketed on April 5, 1972. Briefing was completed on October 3, 1972. The Court of Appeals decision came down on May 10, 1973.

> federal court to the highest state court. Under that procedure, only the certified issue of law would be decided by the state court, and only on the record, in an attempt to avoid disputes over facts." Note, *supra,* 69 YALE L.J. at 654 (footnotes omitted).

See also Note, *Federal Jurisdiction-Abstention-Inter-Sovereign Certification,* 48 IOWA L. REV. 185, 192 (1962). Under certification only the issue of law is referred to the state court, and the right to a federal forum is preserved.

> "The role of the state court would be to simply declare 'authoritatively' what the state law is. It is not doubted that under *Erie* a federal court must follow state law as the rule of decision. Save for considerations of cost and delay which abstention may add to a litigation, it may well be thought that it is irrelevant to the litigants that the judges may ascertain state law by one process or another—by consulting with their law clerks or by abstaining in favor of their state counterparts." Note, *supra,* 73 YALE L.J. at 862.

See also Note, *supra,* 38 TEMP. L. Q. at 82. Thus the only role which the federal court relinquishes is the law-making role, which belongs to the state courts in any event:

> "[D]iversity jurisdiction is intended to create only an alternative forum to ensure evenhanded application of state law and unbiased fact finding—by definition not involved in certification since the certificate establishes the factual situation—, rather than to provide a means of avoiding state court interpretation of state law." Note, *supra,* 111 U. PA. L. REV. at 359.

Specifically, under certification the evidence will be assembled by the use of federal discovery procedure and admitted under liberal federal standards, and the facts will be

found by a jury chosen according to federal standards or by an Article III judge. The rights of a diversity plaintiff are not abridged in any way:

> "Although a certification procedure is used, it is in the federal court that the fact determinations are made, and it is in there that the law derived from the state court in its certified answer will be applied. Therefore, the diversity plaintiff has received all to which he is entitled." Gowen & Izlar, *supra,* 47 TEXAS L. REV. at 210.

There is no real chance that a state supreme court will distort its answer to the certified question in order to prejudice an out-of-state litigant, since its opinion on certification constitutes a precedent affecting all the citizens of the state. See Gowen & Izlar, *supra,* 43 TEXAS L. REV. at 209-10; Liebenthal, *supra,* 18 W. RES. L. REV. at 180. In this context the refusal to permit Florida to decide an important issue of its own law "reflects something of a provincial attitude regarding the fairness of other tribunals." See *The Bremen* v. *Zapata Off-Shore Co.,* 407 U.S. 1, 12 (1972). Here, anyway, the plaintiffs cannot urge, against certification, the policy of diversity jurisdiction of protecting out-of-state litigants, since the interest they represent is a Florida corporation.

Under abstention, difficult *res judicata* questions may arise in a case raising more than a single state law issue. It may be argued that the state court decided other issues and that the plaintiff is bound by such decision on his return to federal court. See, *e.g., England* v. *Louisiana State Board of Medical Examiners,* 375 U.S. 411 (1964); See Note, *supra,* 73 HARV. L. REV. at 1365-68. But such problems do not arise when certification is used:

> "By certifying questions to the state court, the federal court would be in a position to control what

> issues are presented to the state court, reserving to itself the factual determinations and the ultimate resolution of the federal claims. This result would seem to comply with the rule laid down by the Supreme Court in *England*." Lillich & Mundy, *supra*, 18 U.C.L.A. L. REV. at 906 (footnote omitted).

Thus questions will not later arise over what issues the parties litigated in the state court. Note, *Certifying Questions to State Supreme Courts as a Remedy to the Abstention Doctrine*, 9 S. DAK. L. REV. 158, 170 (1964). The Florida court, moreover, has taken care to confine its rulings to the question certified. See, *e.g.*, *National Education Association* v. *Lee County Board of Public Instruction*, 260 So. 2d 206, 210 (Fla. 1972) (federal constitutional issue noted but not ruled upon).

Nor can it be said that a certified question will be too abstract to present the issue fairly. Certificates from the Fifth Circuit to the Supreme Court of Florida normally include a full statement of facts found or alleged, which is drafted by the parties and reviewed by the court before transmittal.[44] The Florida court may require the record to be sent as well.[45] On such basis the question is no more "abstract" than any other issue on appeal, and it can be answered with precision. See Liebenthal, *supra*, 18 W. RES. L. REV. at 202-03.

Since certification provides a positive answer and a state-law precedent instead of a tentative federal forecast, but does so without the practical problems of abstention, it has been greeted as "a better answer" to the problem of determining state law without sacrifice of federal interests:

> "But a better answer seems to be that there is a device which fulfills the needs of our dual system

44. See note 40, *supra*.

45. FLA. APP. RULES, R.4.61(e) (1967), set forth at p. 4, *supra*.

> of government, avoids the problems of scope of state-court action and of res judicata, and affords the parties a quicker decision. The device is inter-jurisdictional certification." Note, *supra*, 73 HARV. L. REV. at 1368.

This writer concludes that certification, "apparently conceived as an aid to the federal courts' discharge of their obligation, under the rule of *Erie R.R.* v. *Tompkins*, to follow state law in diversity cases," should be used by federal courts which find themselves in "situations of genuine perplexity concerning state law." *Id.* Since certification is considered "the most workable cure for the infirmities of the abstention doctrine," Note, *supra*, 38 TEMP. L. Q. at 84, commentators advocate its use even when abstention might not be appropriate:

> "Since at the appellate level the principal cost of abstention is in expense and delay to litigants, the federal court could properly be far more liberal in abstaining where, in the particular case, these factors were demonstrably unimportant, or likely to be held in check by the procedures available in state courts. . . . The Florida certification device, on the other hand, allows litigants to skirt the lower state courts entirely and to obtain a judgment directly from the highest state court in answer to propounded questions of state law, a procedure which may result in considerable savings of time and expense. . . . Given the speed, authority and economy possible using certification procedures, abstention under these procedures could tolerably range a far wider scale of state law questions than abstention implemented by declaratory judgment." Note, *supra*, 73 YALE L. J. at 867-69 (footnotes omitted).

See also Liebenthal, *supra*, 18 W. RES. L. REV. at 201.

4. Certification promotes cooperative judicial federalism.

It must be recognized that techniques such as abstention and certification also serve public interests as a "mecha-

nism for allocating kinds of cases and kinds of issues to state and federal courts," Hofstedler, *Comity and The Constitution: The Changing Roles of the Federal Judiciary*, 47 N.Y.U.L. Rev. 841, 867 (1972). Whether to refer an issue to the state system cannot properly be decided without giving consideration to the most efficient use of judicial resources of both systems. Indeed any concept of comity must include such a concern. Thus for Professor Kurland the Court's 1959 abstention rulings[46] raise two issues of "cooperative judicial federalism":

> "The first is how to utilize the special expertise of each of two judicial systems, State and federal. The second is how to economize on the use of the systems so that one lawsuit will suffice to dispose of the problem rather than permitting two with the possibility of conflicting results as well as multiple costs." Kurland, *supra*, 24 F.R.D. at 487.

As a possible solution to such problems, Professor Kurland explicitly endorsed Florida's certification system. *Id.*, 489-90. Others concur. Deploring the "misallocation of judicial resources" that occurs when a federal court must make an *Erie*-prediction on a complex state law question, Judge Wright has specifically urged certification as a solution.

> "A far more ingenious escape from *Erie's* troubles is the certification procedure. This happens when a federal *appellate* court 'certifies' or remands a troubling question of state law involved in an *Erie* suit to the state *high* court for its resolution. Since certification does not forfeit the parties' rights to all the advantages of a federal trial, it conceivably encompasses the best of all possible worlds." Wright, *supra*, 13 Wayne L. Rev. at 325 (footnote omitted).

46. *Martin* v. *Creasy*, 360 U.S. 219 (1959); *County of Allegheny* v. *Frank Mashuda Co.*, 360 U.S. 185 (1959); *Harrison* v. *N.A.A.C.P.*, 360 U.S. 167 (1959); *Louisiana Power & Light Co.* v. *City of Thibodaux*, 360 U.S. 25 (1959).

State judges also find merit in certification. Justice Samuel J. Roberts of the Supreme Court of Pennsylvania has enthusiastically endorsed certification as the most progressive proposal for cooperation between state and federal courts.

> "[M]y general thesis, that keeping the door between the courtrooms open not only will minimize the friction between federal and state judiciaries, but also will result in more equal treatment of litigants, has just as much vitality in non-constitutional, non-criminal areas. Easily the most significant step yet taken toward establishing a uniform interpretation of *state* law by federal and state courts has been Florida's unique certification procedure. . . .
>
> "Since the initial decision to employ Florida's statute rests with the federal appellate court, the certification procedure clearly can be only as effective as the federal judiciary chooses to make it. . . . Although I believe that the certification procedure should not be invoked indiscriminately, certainly when a previously undecided state question of significant import finds its way into the federal system, certification to the state court will preserve the integrity of local law and forestall a possible conflict with later state decisions." Roberts, *A State Judge Looks at the Federal Courts*, 116 U. Pa. L. Rev. 468, 476 (1968) (italics original).

The Supreme Court of Florida itself welcomes the opportunity to cooperate with federal courts by expounding principles of Florida law:

> "We appreciate the courtesy of the Supreme Court of the United States in allowing this court to participate in the settling of an important principle of *state* jurisprudence." *Aldrich* v. *Aldrich*, 163 So. 2d 276, 277 (Fla. 1964).

Independent *Erie*-prediction and abstention are premised on the necessity for eternal separation between state and federal judicial systems. Certification, in contrast, enables cooperation between those systems, so that each can perform its function more fully:

> "Thus, inter-jurisdictional certification, as illustrated by the *Clay* case, not only achieves the objectives of abstention—to prevent federal invasion of the state lawmaking function and to avoid needless federal-state friction—, but also represents a more perfect attempt at cooperative judicial federalism, since concern for state sovereignty is implemented through a more efficient and simpler proceeding. In addition, by abstaining, a federal court temporarily—if it has stayed the action—or permanently—if it has dismissed the action—severs itself from the case, leaving the state court to make an independent determination of at least the state law issue. Judicial cooperation exists only in the sense that a federal court has deferred to a state court. In inter-jurisdictional certification, however, the federal court actively participates in the resolution of the entire case by framing the state law question, specifying relevant facts and legal issues, and certifying directly to the state's highest court." Note, *supra*, 111 U. PA. L. REV. at 350.

5. There is a consensus that certification accords with modern principles of judicial administration.

The National Conference of Commissioners on Uniform State Laws has recommended, and the American Bar Association has approved, a proposed Uniform Act for the certification of questions of law between state and federal

courts.[47] The accompanying note states that certification provides a solution to the "very difficult problem", arising from *Erie*, of ascertaining state law when there are no precedents in point: "The federal courts have been forced

47. UNIFORM CERTIFICATION OF QUESTIONS OF LAW [ACT] [RULE], HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS 147 (1967), approved and recommended for enactment in all the states by the National Conference of Commissioners on Uniform State Laws, in its conference of July 31 through August 5, 1967, and approved by the American Bar Association at its meeting of August 9, 1967. 53 A.B.A.J. 976 (1967). The accommpanying note states, in part:

"Reasons for Proposed Uniform Act

"Since the announcement in *Erie R. Co.* v. *Tompkins*, 304 U.S. 64 (1938) that federal courts in non-federal matters would be required to follow state law rather than some general common law, the federal courts have been faced with a very difficult problem. This is the ascertainment of state law when the state judiciary has not spoken definitively on the matter. The federal courts have been forced to guess what the state law is. To avoid this awkward situation the federal courts have developed an abstention doctrine under which the federal courts refrain from acting while the litigants turn to the state court to get the definitive statement of the local law. This device has proved to be quite unsatisfactory. See 1A *Moore's Federal Practice* ¶0.203.

"In the search for a suitable technique to assist the federal courts in ascertaining the law of the state, the certified question is now being used. The certifying federal court sends to the state's highest court the question to be answered. The question is considered and the answer given. This is a more rapid method than the use of the abstention doctrine and seems to be a much more orderly way of handling the problem. Within recent years, a group of states have provided for the certification of questions of state law from federal courts to the highest court of the state. The first to provide for such certification was Florida, Florida Stat. Ann., Sec. 25.031. The device has been used with some frequency since its adoption. . . . Although the Court of Appeals for the Fifth Circuit may decide that a question of Florida law is not subject to doubt, it apparently considers the possibility of certification to the Supreme Court of Florida as part of its normal approach to problems of Florida law. . . ." *Id.*, 147-48 (footnotes omitted).

to guess what the state law is." *Id.*, 147. Certification is described as "a more rapid method than the use of the abstention doctrine and seems to be a much more orderly way of handling the problem." *Id.* The note remarks on the frequent use of Florida's certification procedure by the Fifth Circuit and by this Court. It adds that this Court "in *Clay* v. *Sun Insurance Office*, 363 U.S. 207, 212 (1960), seemingly urged the use of certification by the Court of Appeals for the Fifth Circuit." *Id.*, 149, and advocates a uniform act, to promote greater use of certification.

The proposed Uniform Rule, "patterned in large measure on Florida Appellate Rule 4.61", *id.*, 147 n.2, broadly authorizes certification of questions of state law "which may be determinative of the cause then pending in the certifying court and as to which it appears to the certifying court there is no controlling precedent. . . ." *Id.*, 150, §1.

The refusal of the majority below to employ certification is especially hard to accept since one member, and the only judge, on the panel of six lawyers who prepared the Uniform Act was Circuit Judge Waterman, who wrote the majority opinion below in this case. *Id.*, 17.

The American Law Institute has also voted its approval of a proposed codification of certification principles, which authorizes certification in a broad range of circumstances.[48]

48. ALI, STUDY OF THE DIVISION OF JURISDICTION BETWEEN STATE AND FEDERAL COURTS, TENTATIVE DRAFT NO. 6 § 1371(e), at 39 (1968). The proposal provides, in full:

> "(e) A court of the United States may certify to the highest court of a state a question of State Law, if (1) the State has established a procedure by which its highest court may answer questions certified from such court of the United States; (2) the question of State law may be controlling in the action and cannot be satisfactorily determined in the light of the State authorities, and (3) the court expressly finds that

Recognizing that a certification system has substantial advantages to state jurisprudence, in addition to Florida, the states of Colorado[49], Hawaii[50], Louisiana[51], Maine[52], Maryland[53], Massachusetts[54], Montana[55], New Hampshire,[56] and Washington[57] have authorized their highest courts to answer questions of state law certified by federal courts.

6. Certification has been proved in practice.

In practice the Florida certification procedure has proved highly useful to the Court of Appeals for the Fifth Circuit, which includes Florida. Many Florida-law cases involve the difficult problem, presented in this case, of predicting whether the Supreme Court of Florida will choose to adopt a novel doctrine. *Hopkins* v. *Lockheed Aircraft Corp.*,

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certification will not cause undue delay or be prejudicial to the parties." *Id.*

The annexed commentary summarizes the advantages of certification over the usual abstention process:

> "Since the question will be certified to the highest state court, many of the delays incident to ordinary abstention orders, which require instituting a declaratory judgment action in a state court and prosecuting it through the state courts, may be avoided. Furthermore, the form of the question certified and the record sent to the state court with the certification are always under the control of the certifying federal court which can better assure that the right question will be answered on the right facts." *Id.*, 214.

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49. COLO. APP. R.21.1 (1970).

50. HAWAII REV. STAT. §§602-36, 602-37 (1963); HAWAII SUP. CT. R.20 (1968).

51. LA. REV. STAT. ANN. §13:72.1 (Supp. 1973).

52. ME. REV. STAT. ANN., tit. 4, §57 (1965).

53. MD. ANN. CODE art. 26, §161 (1973).

54. MASS. SUP. JUD. CT. RULES, R.3:21 (1971).

55. MONT. SUP. CT. R.1 (1967).

56. N.H. REV. STAT. ANN., §490: APP. R.21 (1968).

57. WASH. REV. CODE ANN. §§2.60.010-.030 (Supp. 1968); WASH. SUP. CT. R. ON APP. 1-67 (Supp. 1968).

358 F.2d 347 (CA5 1966), involved a question of conflicts, an area of rapidly changing law. The plaintiff maintained that Florida would follow an innovative New York Court of Appeals case, *Kilberg* v. *Northeast Airlines, Inc.*, 9 N.Y.2d 34 (1961), in ignoring, on public policy grounds, the limit on wrongful death recovery imposed by the state of the place of the wrong. In view of such decisions and commentary urging a "departure from the traditional doctrine," the Fifth Circuit certified the issue, 358 F.2d at 349. The Florida court expressly rejected the New York rule and held that Florida public policy did not conflict with such restrictions on recovery, *Hopkins* v. *Lockheed Aircraft Corp.*, 201 So.2d 743, 751 (Fla. 1967), adding that the case presented no "justification for abandonment of guiding principles in past decisions . . .," *id.*, 752. On receipt of this answer, the Fifth Circuit strongly endorsed certification in such a case, which presented the problem of "divining the policy considerations which the Supreme Court of Florida would now embrace. For policy it surely is." *Hopkins* v. *Lockheed Aircraft Corp.*, 394 F.2d 656, 656-57 (CA5 1968). Where an independent judgment would be "fraught with great hazards both to litigants and the law," *id.*, 657, certification gave a "clear, positive, final, decisive answer." *Id.* Summary judgment for the defendant was affirmed.

Certification has settled other questions of the Florida court's adherence to principles expressed in Florida precedents.[58]

58. See, *e.g.*, *Allen* v. *Estate of Carman*, 281 So.2d 317 (Fla. 1973) (employer's invocation of exclusive workmen's compensation coverage upheld by analogy with decisions under similar Florida statutes; scope of employment restricted by precedents); *Gordon* v. *John Deere Co.*, 264 So.2d 419 (Fla. 1972) (long-arm statute not retroactive since precedents require retroactive statutes to be explicitly "remedial"); *Boyd* v. *United States Fidelity and Guaranty Co.*, 256 So.2d 1 (Fla. 1972) (insurance coverage not construed broadly where unambiguous, under prior decisions); *Trail Builders Supply Co.* v. *Reagan*, 235 So.2d 482 (Fla. 1970) (workmen's compensation statute held not to alter third party's right to indemnity

The Fifth Circuit has properly refused to second-guess the Florida court's interpretations of state law, *National Educational Association* v. *Lee County Board of Public Instruction*, 467 F.2d 447, 449 (CA5 1972), and expressly understands this Court's ruling in *Kaiser Steel Corp.* v. *W. S. Ranch Co., supra,* as approving its use of certification. *Martinez* v. *Rodriquez,* 410 F.2d 729, 731 n.5 (CA5 1969). Florida has maintained a record of prompt answers to Fifth Circuit certifications; it cannot be doubted that the system works in practice.[59]

This Court has had the benefit of Florida's answers to certified questions four times to date and in each instance demonstrated its advantages to the federal system.

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by employer under common law precedents); *Gaston* v. *Pittman,* 224 So.2d 326 (Fla. 1969) (suit by divorced wife against former husband for tort prior to marriage upheld under precedents analyzing abatement of right to sue); *Martinez* v. *Rodriquez,* 215 So.2d 305 (Fla. 1968) (father's action for death of child barred by mother's negligence under rationale of prior decisions); *Moragne* v. *States Marine Lines, Inc.,* 211 So.2d 161 (Fla. 1968) (Florida wrongful death action based on unseaworthiness rejected under theory of precedents, despite contrary out-of-state decisions and recent statutory amendments; any other course "tantamount to judicial legislation, *id.,* 167).

59. Cases Certified by Court of Appeals for the Fifth Circuit to the Supreme Court of Florida:

Case	Certification	State Decision	Disposition
Clay v. Sun Ins. Off. Ltd.	(unreported) 8-12-60	133 So.2d 735 10-18-61	319 F.2d 505 6-19-63
Green v. American Tobacco Co.	304 F.2d 70 6-20-62	154 So.2d 169 6-5-63	325 F.2d 673 12-11-63
Hopkins v. Lockheed Aircraft Co.	358 F.2d 347 3-24-66	201 So.2d 743 7-26-67	394 F.2d 656 5-16-68
Life Ins. Co. of Virginia v. Shifflet	370 F.2d 555 1-4-67	201 So.2d 715 5-31-67	380 F.2d 375 7-21-67
Martinez v. Rodriquez	394 F.2d 156 5-2-68	215 So.2d 305 10-30-68	410 F.2d 729 4-29-69
Moragne v. States Marine Lines, Inc.	(unreported) 7-11-67	211 So.2d 161 5-29-68	409 F.2d 32 4-1-70
Gaston v. Pittman	405 F.2d 869 1-17-69	224 So.2d 326 5-28-69	413 F.2d 1031 7-17-69
Trail Builders Supply Co. v. Reagan	409 F.2d 1059 4-7-69	235 So.2d 482 3-18-70	430 F.2d 828 8-12-70

The Court had earlier accepted certificates from state courts to clarify points of state law, see *King* v. *Order of United Commercial Travelers of America*, 333 U.S. 153, 160 (1948), but its first mention of the Florida procedure was in *Clay* v. *Sun Insurance Office, Ltd.*, 363 U.S. 207 (1960), where the Court urged its use on remand. Speaking for the Court, Justice Frankfurter praised the procedure:

> "The Florida Legislature, with rare foresight, has dealt with the problem of authoritatively determining unresolved state law involved in federal litigation by a statute which permits a federal court to certify such a doubtful question of state law to the Supreme Court of Florida for its decision. Fla. Stat. Ann., 1957, §25.031." *Id.*, 212 (footnote omitted).

In *Dresner* v. *City of Tallahassee*, 375 U.S. 136 (1963), and again in *Aldrich* v. *Aldrich*, 375 U.S. 75 (1963), the Court directly determined Florida law by certification.[60] Mr. Jus-

Case	Certification	State Decision	Disposition
Boyd v. Bowman	443 F.2d 848 5-17-71	256 So.2d 1 11-24-71	455 F.2d 927 2-14-72
A. R. Moyer, Inc. v. Graham	443 F.2d 434 5-20-71	285 So.2d 397 10-10-73	
Allen v. Estate of Carman	446 F.2d 1276 7-7-71	281 So.2d 317 7-31-73	
Oliva v. Touchton	448 F.2d 437 9-16-71	(unreported dismissal) 6-15-72	
National Education Association v. Lee County Board of Public Instruction	448 F.2d 451 9-16-71	260 So.2d 206 3-15-72	467 F.2d 447 8-25-72
Gordon v. John Deere Co.	451 F.2d 234 11-16-71	264 So.2d 419 7-5-72	466 F.2d 1200 9-18-72

60. Clay was decided on the merits after the certified questions were answered and it was plain that a constitutional issue was presented, *Clay* v. *Sun Ins. Office, Ltd.*, 377 U.S. 179 (1964). The answers of the Supreme Court of Florida in *Dresner* enabled the Court to dismiss the writ of certiorari as improvidently granted, *Dresner* v. *City of Tallahassee*, 378 U.S. 539 (1964), and in *Aldrich* the Court reversed on the basis of the answers:

> "Given the answers of the Florida court, it becomes plain that the judgment of the Supreme Court of Appeals of West Virginia, based as it was on a misapprehension regarding the law of a sister State, cannot stand." *Aldrich* v. *Aldrich*, 378 U.S. 540, 543 (1964).

tice Douglas, concurring in *England* v. *Louisiana State Board of Medical Examiners, supra,* urged use of certification as a more expeditious alternative which would "lighten [the] requirements," *id.,* 432, of abstention:

> "We use [the Florida] procedure on Florida state law perplexities. . . . We cannot require the States to provide such a procedure,—but by asserting the independence of the federal courts and insisting on prompt adjudications we will encourage its use." *Id.,* 434 (concurring opinion).

This Court had the benefit of the answer to a question certified by the Fifth Circuit in *Moragne* v. *States Marine Lines, Inc.,* 398 U.S. 375, 377 (1970), which established a federal remedy for death caused by unseaworthiness. The Florida court stated that its wrongful death statute gave no recovery for death caused by a violation of the " 'completely foreign' maritime duty of seaworthiness," since it enforced only common-law duties. *Id.* 401 n.15. This statement prevented the recurrence of the doubts about state law which troubled the Court in *The Tungus* v. *Skovgaard,* 358 U.S. 588, 595-96 (1959), where the Court suggested abstention might be appropriate in such cases, even though no party had urged it, and enabled the Court to decide an important question of admiralty law, certain that the issue was squarely presented. Moreover, Florida's answer shed light on the problem as well, for the restrictive interpretation of the Florida court demonstrated the "incongruity of forcing the States to provide the sole remedy to effectuate duties that have no basis in state policy." 398 U.S. at 401 n. 15.

Enthusiasm for certification has also been expressed in the Second Circuit. In *Essex Universal Corp.* v. *Yates,* 305 F.2d 572 (CA2 1962), a case like this one involving the duties of corporate fiduciaries under state law, Judge Friendly emphasized the difficulty of predicting without

sufficient precedents what policy New York would adopt on such an issue "of enormous importance to all New York corporations and their stockholders," *id.*, 580 (concurring opinion). He noted that such problems had "led at least one state to authorize its courts to answer questions about its law that a Federal court may ask," *id.*, 580 (footnote omitted), and cited the Florida certification statutes, FLA. STAT. ANN. §§25.031, 25.032 (1961), which the Second Circuit refused to use in this case.

Cornellier v. *American Casualty Co.*, 389 F.2d 641 (CA2 1968), raised the unsettled question whether a coverage limitation in an accident insurance policy violated Vermont public policy. The Second Circuit noted that the need to "divine" state law "makes most attractive the Uniform Certification of Questions of Law Act," *id.*, 644 n.3, and pointed out that Florida and three other states had similar procedures.

Peterson v. *Allcity Insurance Co.*, 472 F.2d 71 (CA2 1972), concerned the measure of damages under New York law for an insurer's bad-faith refusal to settle a claim. The Second Circuit said the case illustrated the difficulty of determining New York law in this developing field and stated that the court might benefit from a "certification statute, similar to that now in effect in various other states, e.g., Florida . . ." *Id.* 80 n.14.

But here, when the opportunity arose to use such an "attractive" procedure, the Second Circuit refused and prevented an authoritative ruling:

> "The *Schein* court took no note of the utilization the Court of Appeals for the Fifth Circuit has recently made of [certification]. . . . Failure to utilize this procedure by the *Schein* court saps the decision's authority as an application of the law of Florida; it is questionable whether a Florida court would feel bound by *Schein*, should it be faced with a similar case." Note, *supra*, 53 B.U.L. REV. at 1158-59.

Instead, it undertook on its own to determine "a problem presenting fundamental and serious questions of state policy with only fragmentary case material with which to work," see *W. S. Ranch Co.* v. *Kaiser Steel Corp., supra*, 388 F.2d at 265 n.15. So doing, it disregarded Florida's statutorily declared interest in developing its own public policy for application in federal courts, ignored the parties' interest in the uniform application of Florida law, and defeated the public interest in the efficient operation of our national judicial system in a manner that settles questions fairly rather than fostering inequity and uncertainty. It failed to honor or even to discuss this Court's decisions requiring abstention and specifically encouraging the use of Florida's certification procedure, despite the firm and explicit protests of Judge Kaufman in dissent. Such action plainly requires reversal. It falls to this Court to remind the lower court that our judicial system encompasses both state and federal courts; that the supposed walls of separation between the court systems were erected by the law, that they can be, and have been here, pierced by the law to permit communication to achieve justice, and that in such case a court should not reject an authoritative statement of the governing law in order to impose its view of good policy upon the people of a distant jurisdiction.

In the face of the uncertainty and confusion created by the ruling below, one certainty remains, plain and incontestable: Florida has an answer for the crucial policy question that governs this case. And Florida has now, in operation, a proved system to provide that answer quickly and with precision. Florida *will* answer. Lehman's position is simple: Why not ask?

CONCLUSION

The judgment of the Court of Appeals for the Second Circuit should be reversed and this case should be remanded with instructions to certify the controlling issue of Florida law to the Supreme Court of Florida for decision by that Court.

Respectfully submitted,

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January 17, 1974

SUPREME COURT, U. S.

IN THE

Supreme Court of the United States

October Term, 1973

No. 73-440

BENJAMIN SIMON,

Petitioner, et al.,

v.

JACOB SCHEIN and MARVIN H. SCHEIN,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF FOR PETITIONER BENJAMIN SIMON

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January 17, 1974

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IN THE

Supreme Court of the United States

October Term, 1973

No. 73-440

BENJAMIN SIMON,

Petitioner, et al.,

v.

JACOB SCHEIN and MARVIN H. SCHEIN,

Respondents.

BRIEF FOR PETITIONER BENJAMIN SIMON

This brief is submitted on behalf of Benjamin Simon, the petitioner in No. 73-440.

Opinion Below

The opinion of the Court of Appeals is reported *sub nom. Schein* v. *Chasen,* at 478 F.2d 817 (2d Cir. 1973). The opinion of the District Court is reported *sub nom. Gildenhorn* v. *Lum's, Inc.,* 335 F. Supp. 329 (S.D.N.Y. 1971).

Jurisdiction

The judgment of the Court of Appeals for the Second Circuit was entered on May 10, 1973. A timely petition for rehearing *en banc* on behalf of petitioner Simon was denied on June 8, 1973. The petition for writ of certiorari on behalf of Simon was filed on September 6, 1973, and the petition was granted by this Court on December 3, 1973. This Court's jurisdiction is invoked under 28 U.S.C. §1254(1).

Statutory Provisions Involved

Fla. Stat. Ann. §25.031 and §25.032 (1961):

Supreme court authorized to receive and answer certificates as to state law from federal appellate courts

"The supreme court of this state may, by rule of court, provide that, when it shall appear to the supreme court of the United States, to any circuit court of appeals of the United States, or to the court of appeals of the District of Columbia, that there are involved in any proceeding before it questions or propositions of the laws of this state, which are determinative of the said cause, and there are no clear controlling precedents in the decisions of the supreme court of this state, such federal appellate court may certify such questions or propositions of the laws of this state to the supreme court of this state for instructions concerning such questions or propositions of state law, which certificate the supreme court of this state, by written opinion, may answer."

Same; rules and regulations

"The supreme court of this state is hereby authorized and empowered to collaborate with any and all other courts of last resort, of other states and of the United States, in the preparation and approval of uniform rules of court to make effective this and similar laws."

Fla. App. R. 4.61 (1967):

Certified questions from federal courts

"a. When Certified. When it shall appear to the Supreme Court of the United States, or to any of the Courts of Appeal of the United States that there are involved in any proceeding before it questions or propositions of law of this state which are determinative of said cause and that there are no clear controlling precedents in the decisions of the Supreme Court of this state, such federal appellate court may certify such questions or propositions of law of this state to the Supreme Court of Florida for instructions concerning such questions or propositions of state law.

b. Jurisdiction. Questions or propositions of law referred to in sub-paragraph a hereof shall be certified for answer to the Supreme Court of this state.

c. Method of Invoking Rule. The provisions of this rule may be invoked by any of the federal courts referred to in sub-paragraph a hereof upon its own motion or upon the suggestion or motion of any interested party when approved by such federal court.

d. Contents of Certificate. The certificate provided for herein shall contain the style of the case, a statement of facts showing the nature of the cause and the circumstances out of which the questions or propositions of law arise and the question of law to be answered.

e. Preparation of Certificate. The certificate may be prepared by stipulation or as directed by such federal court. When prepared and signed by the presiding judge of said federal court, it shall be certified to the Supreme Court by the Clerk of the federal court and under its official seal. The Supreme Court may, in its discretion, require the original or copies of all or any portion of the record before the federal court to be filed with said certificate where, in its opinion, such record may be necessary in the determination of said cause.

f. Costs of Certificate. The costs of the certificate and filing fee shall be equally divided between the parties unless otherwise ordered by this Court.

g. Briefs and Argument. The appellant or moving party in the federal court shall file and serve upon its adversary its brief on the question certified within 30 days after the filing of said certificate in the appellate court of this state having jurisdiction. The appellee or responding party in the federal court shall file and serve upon its adversary its brief within 20 days after the receipt of appellant's or moving party's brief and a reply brief shall be filed within 10 days thereafter.

h. Oral Argument. Oral argument may be granted upon application and, unless for good cause shown the time be enlarged by special order of the Court prior to the hearing thereon, the parties shall be allowed the same time as in other causes on the merits."

Question for Review

Whether the Second Circuit erred by deciding the significant and novel Florida law question presented by this case without reference to Florida authority when it could, by using Florida's certification procedure, have obtained an authoritative answer to that question from Florida's Supreme Court.

Statement of the Case

These shareholders' derivative suits were brought in the United States District Court for the Southern District of New York on behalf of Lum's, Inc., a Florida corporation engaged in the fast-food franchising business.* The sole basis for jurisdiction was diversity of citizenship. The District Court below ruled the controlling law to be that of Florida, where the derivative defendant Lum's was incorporated (52a-54a);** this finding was not challenged by the plaintiffs on appeal and was accepted by the Second Circuit (65a-66a).

The complaints in these cases allege that the defendant Melvin Chasen, in his capacity as Chief Executive Officer of Lum's, learned on or about January 5, 1970 that the

* Three actions were before the District Court below: *Schein* v. *Chasen, Gregorio* v. *Lum's* and *Gildenhorn* v. *Lum's*. The defendants, in addition to the derivative defendant Lum's, Inc., were Lum's chief executive officer, Melvin Chasen; the brokerage firm of Lehman Brothers and (in the *Schein* action only) one of its registered representatives, Benjamin Simon; Investors Diversified Services, Inc. ("IDS"), two IDS fund managers, Eugene Sit and James Jundt (in *Gregorio* and *Schein*) and (in *Schein* and *Gildenhorn*) two IDS mutual funds, Investors Variable Payment Fund and IDS New Dimensions Fund, Inc.

The *Gregorio* suit, originally brought in the Northern District of Illinois, was transferred to the Southern District of New York on consent and the complaint (originally brought on an altogether different theory) amended to plead a derivative claim similar to *Schein*. Petitioner Simon was not included as a defendant in the *Gregorio* suit because both he and plaintiff Gregorio are Illinois residents (*Gregorio* Amended Complaint ¶3, 24a), so that diversity would have been defeated if he had been joined. The plaintiffs in *Schein* are Maryland residents (*Schein* Complaint ¶1, 14a). The derivative defendant Lum's and its officer, Chasen, were in Florida; Lehman Brothers in New York, and the IDS defendants in Minnesota (*Schein* Complaint ¶¶1-11, 15a-16a).

** References with the suffix "a" are to the Appendix herein.

company's projected earnings for fiscal 1970 were being revised substantially downward from the estimate which had been previously announced to the public. It is claimed that Chasen, in a January 8 telephone call, imparted this information to Simon, a registered representative employed by Lehman Brothers, and that Simon the same day passed it on to an IDS portfolio manager, who in turn relayed it to a colleague. The next morning, January 9, the defendant IDS funds sold a total of 83,000 shares of Lum's stock at approximately $17.50 per share. Later that day, a Friday, news of the downward revision of Lum's earning projections was publicly announced. When trading resumed the following Monday, the opening price was $14.00 per share. (*Schein* Complaint ¶¶16-24, 17a-19a; *Gregorio* Amended Complaint ¶¶13-20, 27a-30a).

The *Schein* complaint asserts that Chasen, by disclosing confidential information concerning Lum's, breached the fiduciary duty he owed to that company, and that Simon, Lehman Brothers and the IDS defendants "aided and abetted" Chasen in his breach of duty by "[using] the aforesaid confidential information for their own personal profit." (*Schein* Complaint ¶¶16, 18, 25, 17a-20a). The *Schein* complaint demands that the defendants be held liable to Lum's for their "unlawful profits (including commissions)" and for "the damages it [Lum's] sustained thereby" (*Id.* at ¶25, 20a). The *Gregorio* complaint makes not even a conclusory allegation of damage to Lum's, but asserts that defendants "must account to Lum's, Inc. for the profits realized by them." (*Gregorio* Amended Complaint ¶22, 30a).

Notwithstanding the allegation in both complaints that Simon and Lehman Brothers "profited" by the conduct

complained of, it was established below by uncontradicted proof that the IDS sales of January 9, 1970 were not made through Lehman Brothers and that neither Simon nor Lehman Brothers received any commission or other profit in connection with those sales. (Simon Affidavit ¶3, 37a; Lisle Affidavit ¶2, 44a). The District Court accordingly found—and its finding is uncontested on this record—that the "broker-dealer defendants * * * did not profit by virtue of the sales" (55a).

On motions pursuant to Fed. R. Civ. P. 12(b) (6) to dismiss the complaints for failure to state a claim,* the District Court first rejected respondents' contention that New York law applied, concluding rather that the law of Florida controlled because

> "* * * Florida has the paramount interest in defining and enforcing fiduciary obligations owing to corporations incorporated and doing business within its borders" (53a).

Turning to Florida precedents, Judge Tyler found that Florida case law requires a derivative plaintiff to show damage to the corporation by reason of the alleged breach of trust: *Palma* v. *Zerbey,* 189 So. 2d 510, 511 (Fla. App. 1966), *cert. denied* 200 So. 2d 814 (Fla. 1967), and cases cited therein. The *Gregorio* complaint claimed no such damage and the *Schein* complaint's allegation of damage was wholly

* Motions by defendants Chasen, Sit and Jundt pursuant to Fed. R. Civ. P. 12(b) (2) to dismiss for lack of personal jurisdiction were granted in the District Court and not appealed. A similar motion by petitioner Simon was not passed upon by the District Court, evidently because dismissal was ordered as to Simon on the alternative ground, pursuant to Fed. R. Civ. P. 12(b) (6), of failure to state a claim upon which relief could be granted. No appeal was taken as to any party from the District Court's dismissal of the *Gildenhorn* suit.

conclusory. The District Court found no Florida authority, however, as to the degree of specificity required in pleading corporate damage. For that reason, and in light of the "possibility" that Florida might follow the New York decision in *Diamond* v. *Oreamuno,* 24 N.Y.2d 494, 248 N.E.2d 910, 301 N.Y.S.2d 78 (1969), which dispensed altogether with the damage requirement, the District Court went on to consider whether the complaints were sufficient even under the *Diamond* rule (54a).

Diamond v. *Oreamuno* was a derivative suit against a company's Chairman and President alleging that they had learned, by virtue of their corporate positions, of a decrease in the company's earnings and had sold stock of the company before news of the decrease became public. At the outset of the New York Court of Appeals' opinion, Chief Judge Fuld stated that "the question presented—one of first impression in this court—is whether *officers and directors* may be accountable to their corporation for gains realized by them from transactions in the company's stock as a result of their use of material inside information." 24 N.Y.2d at 496, 248 N.E.2d at 911, 301 N.Y.S.2d at 79 (emphasis added). In holding that such liability might be imposed, the Court of Appeals reasoned that confidential information about a company is its property and cannot be appropriated by those who owe it a fiduciary duty, regardless of whether the corporation is damaged by the fiduciary's breach:

> "In our opinion, there can be no justification for permitting officers and directors, such as the defendants, to retain for themselves profits which, it is alleged, they derived solely from exploiting information

> gained by virtue of their inside position as corporate officials." 24 N.Y.2d at 498-99, 248 N.E.2d at 912, 301 N.Y.S.2d at 81.

Since the liability imposed in *Diamond* was predicated on a breach of fiduciary duty, the District Court held that the *Diamond* rule did not extend to third parties such as Simon, Lehman Brothers and IDS, who were not fiduciaries of Lum's and whose conduct could not constitute a breach of duty owed to that company. Moreover, since the liability found in *Diamond* was a liability to account for improperly obtained profits, dismissal of the instant complaints was required as to Simon and Lehman Brothers because these defendants, as the District Court found, had made no profits and had nothing for which to account. Noting that the New York Court of Appeals in *Diamond* had affirmed the dismissal of that suit as to other officers of the company alleged to have aided and abetted the primary defendants by concealing their activities, the District Court concluded that the unique *Diamond* rule did not reach the present case:

> "In view of the fact that the New York Court of Appeals could not bring itself to find liability for intercorporate conspirators, I fail to perceive how this court could extend *Diamond* to cover extra-corporate conspirators and tippees. Accordingly, I conclude that with regard to all defendants save Chasen, the complaints herein fail to state a claim for which relief can be granted." (56a)

The Court of Appeals for the Second Circuit, with Judge Kaufman dissenting, reversed. Saying that its "foray" into Florida law disclosed that "the Florida court has never faced the precise issues which are present in this action," the majority below readily turned for "persuasive author-

ity" to the New York decision in *Diamond* (66a). Having assumed that a Florida court would decide this case under *Diamond,* the court then assumed that Florida would extend the first-impression *Diamond* holding to reach the non-fiduciary, non-profiting defendants in this case because "*Diamond*, the law of the jurisdiction in which the New York Stock Exchange is seated, has the prophylactic effect of providing a disincentive to insider trading" (69a), and because the court thought a state remedy necessary to prevent "immunized outsiders" from escaping liability in situations where "federal private and governmental Rule 10b-5 actions are impractical" (69a).*

The Second Circuit's opinion, though replete with citations of federal decisions from several jurisdictions, many of them arising under the federal securities acts, touches on Florida law at only two points. Reasoning that a "tippee" who acquires "inside" information thereby becomes invested with a duty to those investors who are damaged by his conduct, as in *SEC* v. *Texas Gulf Sulphur Co.,* 446 F.2d 1301 (2d Cir. 1971), the court concluded that a stranger who acquires confidential information about a company becomes *ipso facto* that company's fiduciary as well (69a-71a). To support this novel concept, the Court of Appeals cited the Florida case of *Quinn* v. *Phipps,* 93 Fla. 805, 113 So. 419 (1927) for the proposition that Florida does not limit fiduciary liability to "technical fiduciaries" (70a). The issue in *Quinn,* however, was whether a real estate broker who negotiated for himself the purchase of property could be

* This was not such a situation. Both an SEC enforcement action, *SEC* v. *Lum's, Inc.,* 70 Civ. 1734 (S.D.N.Y., filed December 7, 1970) and a stockholder's class action for damages, *Sanders* v. *Lum's, Inc.,* 71 Civ. 5331 (S.D.N.Y., filed March 12, 1971) were pending when this case was heard by the Court of Appeals.

compelled to account to the client on whose behalf he was supposed to have acted: a finding that a fiduciary relationship existed was, of course, the basis on which liability was imposed. *Quinn* was the sole Florida authority adduced to support the majority's result. On the other critical question of whether Florida law permits a corporation to recover regardless of whether it has sustained damage, the court disposed of the roadblock case of *Palma* v. *Zerbey,* 189 So. 2d 510 (Fla. App. 1966), *cert. denied* 200 So. 2d 814 (Fla. 1967), in a footnote as "* * * a one paragraph per curiam opinion of a lower Florida court, the Florida District Court of Appeals which, inasmuch as it fails to provide a discussion of the issues, we find to be totally unpersuasive" (72a, n.9).

Judge Kaufman, in dissent, agreed with the District Court that the majority's expansive reading of *Diamond* was incorrect as a matter of New York law and that the rationale of *Diamond* has no application to persons such as Simon and Lehman Brothers, who owed no fiduciary duty to the corporation and who had no profits for which to account. Noting the absence of authority in Florida or any other state to support the majority's assumption that Florida would "give an unprecedented expansive reading" to *Diamond,* Judge Kaufman said that the court "* * * exceeds its authority by substituting its own view of what state law ought to be, for what the state law actually is" (80a). Judge Kaufman concluded:

> "Moreover, since the outcome of this case turns, ultimately, upon Florida law, I fail to comprehend why my brothers refuse to utilize Florida's certified question statute, Fla. Stat. Ann. §25.031. This enlightened law provides for certification to the Florida Supreme Court by a federal appellate court of an un-

resolved question of Florida law which is determinative of a case before it and on which there are no clear, controlling Florida Supreme Court precedents * * * The uncertainty inherent in the majority's speculation over what the Florida courts would decide if faced with this novel question of tippee liability under state common law fiduciary principles in a stockholders' derivative action would be dispelled authoritatively and finally." (80a-81a) (footnote omitted).

Summary of Argument

This case should have been decided under Florida law. It was not. Judge Kaufman pointed out in his dissent below that the "* * * view that a tippee is cloaked with state law fiduciary obligations to the corporation whose shares he trades is an unknown and untenable legal concept" (79a). Decided under cover of darkness as to Florida law, the Second Circuit's result in this case is in fact an imaginative piece of legislation enacted to plug what the majority below perceived to be a possible loophole in the federal securities acts. As a recent note on this case says, "*Schein* has created, in effect, a new duty owed by outsiders to the corporation" and "should spawn a new breed of inside information cases." Note, 42 FORDHAM L. REV. 211, 224, 223 (1973).

Before "spawning a new breed of inside information cases", the Second Circuit should have stopped to certify the question presented by this case to Florida's Supreme Court, as the Fifth Circuit would have done if this case had been before it. With certification, the Second Circuit's deference to Florida's law and policy would have

been real instead of feigned. With certification, the court's decision, instead of resting on unsupported speculation as to how Florida would view the case, would have rested on an authoritative Florida pronouncement. With certification, the litigants here would have been assured the benefit of the same rule which would have been applied in a Florida state court but for the accident of federal jurisdiction, and litigants in future cases would have known either that such claims were not maintainable or that they could just as well be asserted in Florida's courts as in the federal courts of the Second Circuit. With certification, the goal of uniformity laid down by *Erie R.R.* v. *Tompkins,* 304 U.S. 64 (1938), could have been realized without the delay, expense or impairment of federal jurisdiction associated with abstention. There was much to gain by certification in this case and nothing to lose: the Second Circuit erred by not making use of the procedure here.

ARGUMENT

I

In this case, where the Second Circuit could find no basis in Florida law for its decision, it was error to disregard the certification procedure by which an authoritative answer might have been supplied.

As this Court said in *Angel* v. *Bullington,* 330 U.S. 183, 191 (1947), "The essence of diversity jurisdiction is that a federal court enforces State law and State policy." The federal court's function in such a case "* * * is to ascertain what the state law is, not what it ought to be", *Klaxon Co.* v. *Stentor Electric Manufacturing Co., Inc.,* 313 U.S. 487, 497 (1941). All available sources of state law must be ex-

plored, for the federal court is not free to choose its own rule of decision merely because the state's highest court has not spoken:

> "State law is to be applied in the federal as well as the state courts and it is the duty of the former in every case to ascertain from all the available data what the state law is and apply it rather than to prescribe a different rule, however superior it may appear from the viewpoint of 'general law' and however much the state rule may have departed from the prior decisions of the federal courts." *West* v. *American Telephone & Telegraph Co.*, 311 U.S. 223, 237 (1940).

See also Bernhardt v. *Polygraphic Co. of America, Inc.*, 350 U.S. 198 (1956); *King* v. *Order of United Commercial Travelers of America*, 333 U.S. 153 (1948).

The Second Circuit's task of finding and applying Florida law in this case was a difficult one, because the question presented here was truly novel. Neither Florida's courts nor the courts of any other state have ever been called upon to decide whether a corporation whose stock is traded on the basis of non-public information has a right of action against third parties such as Simon and Lehman Brothers who were not its fiduciaries and who did not profit from the transaction. It was not necessary, however, for the Second Circuit either to speculate as to how Florida's courts would decide this question or to prescribe a rule of its own: an authoritative answer could have been obtained by using Florida's procedure for the certification to her Supreme Court of unresolved questions of Florida law arising in the federal court.* By adopting that procedure Florida offered

* FLA. STAT. ANN. §§25.031-25.032 (1961); FLA. APP. R. 4.61 (1967), set forth in full under "Statutory Provisions Involved" *supra*.

the federal appellate courts an available source of data, *West* v. *American Telephone & Telegraph Co.*, 311 U.S. 223, 226 (1940), as to its law. Since it was unable to ascertain Florida law by any other means, the Second Circuit should have used that procedure here.

A. The Customary Methods of Finding State Law Either Were Not Used in This Case or Were Inadequate to Supply a Reasonable Basis for Determining Florida Law.

Having ascertained from its "foray" into Florida law that Florida's Supreme Court has never passed upon the "precise issues" presented by this case (66a), the Second Circuit did not pause, as a Florida court would have done, to look for guidance in Florida authorities as to Florida's treatment of fiduciary relationships in other situations, the circumstances in which its courts recognize a new common-law right in the absence of legislative action, their definition of "aiding and abetting", its policy with respect to derivative litigation, and the views of Florida's courts and Legislature in the securities field. Instead, the Court of Appeals turned to more familiar territory, the New York Court of Appeals' decision in *Diamond* v. *Oreamuno*, and stretched *Diamond* to fit the Procrustean bed of "the desirability of tightening the law of insider trading" (70a).

The Second Circuit had, in the first place, no basis in Florida authority for assuming that a Florida court would have adopted *Diamond* as its rule of decision in this case. To justify its reliance for "persuasive authority" on *Diamond*, the Second Circuit relied on lower federal court cases

which say that a federal court, confronted with a question not passed upon by the courts of the state concerned, may reasonably assume that its courts would apply the "majority rule" (66a).* This Court has never sanctioned a method of finding state law which looks to the "majority rule", but even if that method were valid it would not justify the Court of Appeals' reliance on *Diamond* because *Diamond*, far from being a "majority rule", is the law of only one state—New York. In order to adopt *Diamond*, moreover, a Florida court would have had to overrule or distinguish the case of *Palma* v. *Zerbey*, 189 So. 2d 510, 511 (Fla. App. 1966), *cert. denied* 200 So. 2d 814 (Fla. 1966) and other cases cited therein, which require—unlike *Diamond*—that a corporation allege damage as well as wrongdoing to sustain a cause of action. *Compare Bernhardt* v. *Polygraphic Co. of America, Inc.*, 350 U.S. 198 (1956), holding that a federal court was required to follow two 1910 Vermont cases in the absence of any evidence that Vermont had changed her views in the interim even though courts in most other jurisdictions had done so.

Nor did the Second Circuit have a reasonable basis in either New York or Florida law to support its further assumption that either a New York court or a Florida court would extend *Diamond* to reach the non-profiting, non-fiduciary defendants in this case. *Diamond* was based on traditional equitable principles relating to the duties of a fiduciary and on equity's distaste for allowing a fiduciary to profit from his office. That rationale has no application to persons who are not fiduciaries and in the regulation of

* *Baxter* v. *Lancer Industries, Inc.*, 213 F. Supp. 92 (E.D.N.Y.), *appeal denied*, 324 F.2d 286 (2d Cir. 1963), and *Locke Mfg. Cos.* v. *United States*, 237 F. Supp. 80 (D. Conn. 1964).

whose conduct the corporation has no interest. To bring the third-party defendants here within the reach of *Diamond*, the Second Circuit in this case relied on the antitrust principle of tacit collusion* (to explain how the defendants could be charged with a common enterprise even though the complaints did not plead one), on the doctrine of corporate opportunity in a conspiracy context** (even though trading in its securities does not deprive a corporation of any profit and no conspiracy was here alleged), and finally, and most heavily, on the felt necessity of two circuit judges of the "strong desirability of tightening the law of insider trading" (70a), with liberal citation of *SEC* v. *Texas Gulf Sulphur*, 446 F.2d 1301 (2d Cir. 1971), and other cases arising under the federal securities acts. With the exception of *Quinn* v. *Phipps*, 93 Fla. 805, 113 So. 419 (1927), which deals with the liability of a real estate broker who negotiates the purchase of property for himself instead of for his client, the law and policy of Florida are conspicuously absent from this elaborate structure. Even an admirer of the result in this case could hardly contend that it is what it is supposed to be—the law of Florida applied to the facts alleged in the *Schein* and *Gregorio* complaints.

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* *See American Tobacco Co.* v. *United States*, 328 U.S. 781 (1946), and other cases cited in the court's opinion at 67a.

** *See Oil & Gas Ventures-First 1958 Fund, Ltd.* v. *Kung*, 250 F. Supp. 744, 749 (S.D.N.Y. 1966), and cases cited by the court below at 68a.

B. By Using Florida's Certification Procedure, the Court of Appeals Could Have Found—Instead of Pretending to Find—Florida Law.

The difficulty of obeying *Erie's* command in cases where state law is genuinely confused or non-existent has long troubled the federal courts. Judge Clark of the Second Circuit termed this situation "without hesitation the most troublesome" consequence of the *Erie* decision. Clark, *State Law in the Federal Courts: The Brooding Omnipresence of Erie* v. *Tompkins*, 55 YALE L.J. 267, 290 (1946). In *Nolan* v. *Transocean Air Lines*, 276 F.2d 280 (2d Cir. 1960), Judge Friendly remarked:

> "Our principal task, in this diversity of citizenship case, is to determine what the New York courts would think the California courts would think on an issue about which neither of them has thought." 276 F.2d at 281.

After this Court remanded *Nolan* to the Second Circuit, 365 U.S. 293 (1961), to consider the effect of a new California decision, the Court of Appeals adhered to its original view but professed itself even more perplexed as to the state of California law. Judge Friendly said:

> "* * * [W]e should have been happier if the Court's mandate had allowed of some procedure to permit this recently created conflict between California dictum and California decisions to be settled by the only court that can authoritatively settle it, rather than requiring us to continue two-dimensional surmise." *Nolan* v. *Transocean Air Lines*, 290 F.2d 904, 905-06 (2d Cir. 1961).

See also Corneillier v. *American Casualty Co.*, 389 F.2d 641 (2d Cir. 1968); *Peterson* v. *Allcity Insurance Co.*, 472 F.2d 71 (2d Cir. 1972).

The same difficulty troubled this Court in *The Thungus* v. *Skovgaard*, 358 U.S. 588 (1959):

> "Yet the fact is that the New Jersey courts have simply not spoken upon the question of whether in a case such as this maritime law or common law is applicable under the State's Wrongful Death Act. * * * An effort to resolve that question here, no less than the effort of the Court of Appeals, could be nothing more than prediction, a prediction that might tomorrow be proved wrong by the courts of New Jersey, which alone have power to render an authoritative interpretation." 358 U.S. at 595.

Noting that the possibility of abstention by the federal court had not been raised or argued before the Court, Mr. Justice Stewart said that before disposing of the case in that way "important and competing jurisdictional considerations would have to be thoroughly evaluated"; consequently the Court would not disturb the New Jersey Court of Appeals' *en banc* interpretation of the New Jersey statute. 358 U.S. at 596.

The necessity of making a "prediction that might tomorrow be proved wrong" which troubled the Court in *Skovgaard*, and the unrealistic "two-dimensional surmise" which troubled Judge Friendly in *Nolan*, could have been avoided in this case by use of Florida's certification procedure. Indeed, it was this Court which, in response to the Fifth Circuit's profession of difficulty in deciding a Florida question, first directed the attention of the bench and bar to the existence of the Florida statute, passed in 1945 but never used until this Court's decision in *Clay* v. *Sun Insurance Office, Ltd.*, 363 U.S. 207 (1960).

In *Clay*, the Fifth Circuit had found it unclear whether a Florida statute applied to a provision of the insurance policy in question, but held that application of the statute would in any event be inconsistent with due process. This Court reversed, directing the Fifth Circuit to determine the state law issue before reaching the constitutional question, but went on to propose that the Fifth Circuit resolve its Florida law dilemma by using the certification procedure:

> "But, as the Court of Appeals indicated, it could not, on the available materials, make a confident guess how the Florida Supreme Court would construe the statute. [Citations omitted.] The Florida Legislature, with rare foresight, has dealt with the problem of authoritatively determining unresolved state law involved in federal litigation by a statute which permits a federal court to certify such a doubtful question of state law to the Supreme Court of Florida for its decision." 363 U.S. at 212.

Since *Clay*, this Court has twice used Florida's certification procedure to clear up unclear questions of Florida law, on both occasions to apparent good effect. In *Aldrich* v. *Aldrich*, 375 U.S. 249 (1963), certiorari had been granted to determine whether a West Virginia decision invalidating a provision of a Florida divorce decree complied with the Full Faith and Credit Clause. After receiving the Florida Supreme Court's response, this Court said:

> "Given the answers of the Florida court, it becomes plain that the judgment of the Supreme Court of Appeals of West Virginia, based as it was on a misapprehension of the law of a sister State, cannot stand." 378 U.S. 540, 543.

In the second case, Florida's answers to questions relating to the jurisdiction of her courts resulted in dismissal of this Court's writ of certiorari as improvidently granted: *Dresner* v. *Tallahassee, questions certified at* 375 U.S. 136 (1963), *certified questions answered,* 164 So.2d 208 (Fla. 1964), *petition for cert. dismissed,* 378 U.S. 539 (1964).

The Fifth Circuit since *Clay* has used Florida's certification procedure on several occasions* when the controlling state law question before it was both significant and unclear. In *Green* v. *American Tobacco Co.,* 304 F.2d 70 (5th Cir. 1962), *certified questions answered,* 154 So. 2d 169 (Fla. 1963), *after certification,* 325 F.2d 673 (1963), Judge Rives had occasion to thank Florida's Supreme Court for saving him from error in a case where the Florida answer turned out to be contrary to an opinion he had previously written for a divided panel of the Fifth Circuit but which had been withdrawn to permit certification. In *Martinez* v. *Rodriques,* 410 F.2d 729 (5th Cir. 1969), Judge Brown again praised the certification procedure: "Now the guesswork has been eliminated, and we are quickly presented with a definitive explication of Florida law." 410 F.2d at 730. *See also National Education Association, Inc.* v. *Board of Public Instruction,* 467 F.2d 447 (5th Cir. 1972).

The impact of certification was felt in *Moragne* v. *States Marine Lines, Inc.,* 398 U.S. 375 (1970), where a federal remedy for death caused by unseaworthiness was estab-

* *See, e.g., Gordon* v. *John Deere Co.,* 451 F.2d 234 (5th Cir. 1971); *Allen* v. *Estate of Carman,* 446 F.2d 1276 (5th Cir. 1971); *A. R. Moyer, Inc.* v. *Graham,* 443 F.2d 434 (5th Cir. 1971); *Boyd* v. *Bowman,* 443 F.2d 848 (5th Cir. 1971); *Trail Builders Supply Co.* v. *Reagan,* 409 F.2d 1059 (5th Cir. 1969); *Gaston* v. *Pittman,* 405 F.2d 869 (5th Cir. 1969); *Life Ins. Co. of Va.* v. *Schifflet,* 370 F.2d 555 (5th Cir. 1967).

lished against a long line of contrary precedent. The Florida court had previously said, on questions certified to it by the Fifth Circuit, that its wrongful death statute provided no such remedy, 211 So. 2d 161 (Fla. 1968), thus answering for Florida the question which had troubled the Court under New Jersey law in the *Skovgaard* case. Florida's answer that its common-law remedy was not available framed the federal remedy issue more clearly for this Court by spotlighting "the incongruity of forcing the States to provide the sole remedy to effectuate duties that have no basis in state policy", 398 U.S. at 401 n. 15. By not employing Florida's certification procedure in this case, the Second Circuit did precisely what the Fifth Circuit avoided by using the procedure in *Moragne*: it forced upon Florida a remedy to effectuate a duty which had no discernible basis in Florida's law or policy.

This Court generally refuses to disturb the state law determinations of the lower federal courts, in part because in most cases the federal court is called to pass upon the law of the state in which it sits and is as well equipped as this Court to find state law, and in part because—short of abstaining altogether—there is no alternative. *See, e.g., MacGregor* v. *State Mutual Co.*, 315 U.S. 280 (1942); *The Thungus* v. *Skovgaard*, 358 U.S. 588 (1969). Neither of these considerations applies to this case. The Second Circuit, whatever its expertise in interpreting New York law, can lay claim to none in interpreting the law of Florida. Here, moreover, the federal judges who heard this case were evenly divided as to whether the complaints stated a claim for relief even under New York law, Judge Tyler in the District Court and Judge Kaufman in the Court of Appeals being strongly of the view that they did not. Nor is it necessary to accept the Second Circuit's result here as

the best the federal courts can do in an unclear state law situation. Certification offered the Second Circuit here an efficient means of obtaining an authoritative answer to its Florida law dilemma. "Informed local courts may find meaning not discernible to an outsider," *Louisiana Power & Light Co.* v. *Thibodaux,* 360 U.S. 25, 30 (1959). It was not for the Court of Appeals to assume that Florida had no answer to the question presented by this case; its duty was rather to invoke the procedure provided by Florida for supplying that answer.

II

Use of Florida's certification procedure in this case would have served compelling interests, not only of comity and equity, but of the federal court system as well.

In *Erie R.R.* v. *Tompkins,* 304 U.S. 64, 80 (1938), this Court recognized that the federal courts, by making their own instead of following state law, had "invaded rights which in our opinion are reserved by the Constitution to the several States." *Erie* sought to end that invasion by laying down a rule of uniformity

> "* * * to insure that, in all cases where a federal court is exercising jurisdiction solely because of the diversity of citizenship of the parties, the outcome of the litigation in a federal court should be substantially the same, so far as legal rules determine outcome of a litigation, as it would be if tried in a State court." *Guaranty Trust Co.* v. *York,* 326 U.S. 99, 109 (1945).

Erie's rule of uniformity, as restated by the Court in *Hanna* v. *Plumer,* 380 U.S. 460, 467-68 (1965), had the twin function

of avoiding both inequity in administration of the law and the kind of forum-shopping which had grown up under *Swift* v. *Tyson,* 16 Pet. 1 (1842). All of these concerns—equality of treatment under the law, the avoidance of forum-shopping and due regard for the role of the states as the primary expositors of state law—required the Second Circuit to use Florida's certification procedure in this case where the alternative, as the court's opinion plainly reveals, was a decision without any rational basis in Florida law at all.

A. Certification Assures Uniformity of Law.

Where state law is genuinely unclear, the federal court's decision is necessarily speculative, a "dubious and tentative forecast." *Louisiana Power & Light Co.* v. *Thibodaux,* 360 U.S. 25, 29 (1959); *accord, Chicago* v. *Fieldcrest Dairies,* 316 U.S. 168 (1942). Like any decision based on speculation, such a decision is unsound. It may also prove, upon a subsequent state court decision, to have been erroneous, with the consequence that rights of the parties in the federal case will have been determined by a different rule than that applied to others whose suits are brought in the state court.

The threat to uniformity posed by the prospect that the state court might reach a different conclusion is, of course, one of the primary considerations associated with this Court's abstention doctrine. In *Thompson* v. *Magnolia Petroleum Co.,* 309 U.S. 478 (1940), the Court held that a railroad's bankruptcy trustee should seek an Illinois determination as to whether the railroad or other claimants had the right to drill for oil under the railroad's right of way. The circumstance which impelled the Court to

reach this result was the difficulty of ascertaining Illinois law on the question, as evidenced by the fact that two federal Courts of Appeals had reached conflicting conclusions. The Court said:

> "Unless the matter is referred to the state courts, upon subsequent decision by the Supreme Court of Illinois it may appear that rights in local property of parties to this proceeding have—by the accident of federal jurisdiction—been determined contrary to the law of the State, which in such matters is supreme." 309 U.S. at 484 (footnote omitted).

In *Louisiana Power & Light Co.* v. *Thibodaux,* 360 U.S. 25 (1959), the Court's decision upholding the District Court's decision to abstain as a matter of discretion rested on the twin circumstances of unclear state law (an unconstrued state statute and a state Attorney General's opinion questioning its validity) and an issue, touching on the power of eminent domain, which was of particular significance to the state:

> "A Louisiana statute apparently seems to grant such a power. But that statute has never been interpreted, in respect to a situation like that before the judge, by the Louisiana courts and it would not be the first time that the authoritative tribunal has found in a statute less than meets the outsider's eye. Informed local courts may find meaning not discernible to the outsider. The consequence of allowing this to come to pass would be that this case would be the only case in which the Louisiana statute is construed as we would construe it, whereas the rights of all other litigants would be thereafter governed by a decision of the Supreme Court of Louisiana quite different from ours." 360 U.S. at 30.

In *Kaiser Steel Corp.* v. *W. S. Ranch Co.*, 391 U.S. 593 (1968), this Court held unanimously that the lower federal courts had erred in refusing to abstain in a diversity action involving the right of a private business to condemn land to obtain access to water. That issue, as the Court said:

> "* * * is one of vital concern in the arid State of New Mexico, where water is one of the most valuable of natural resources. The question, moreover, is a truly novel one. The question will eventually have to be resolved by the New Mexico courts, and since a declaratory judgment action is actually pending there, in all likelihood that resolution will be forthcoming soon. Sound judicial administration requires that the parties in this case be given the benefit of the same rule of law which will apply to all other business and landowners concerned with the use of this vital state resource." 391 U.S. at 594.

Subsequent events demonstrated the correctness of the Court's decision in *Kaiser,* for the outcome of the declaratory judgment proceeding in New Mexico's Supreme Court was indeed contrary to the Tenth Circuit's "prediction". *Compare Kaiser Steel Corp.* v. *W. S. Ranch Co.*, 81 N.M. 414, 467 P.2d 986 (1970) *with W. S. Ranch Co.* v. *Kaiser Steel Corp.*, 388 F.2d 257 (10th Cir. 1968).

A certification procedure such as Florida's makes it possible for the federal court, in a case where state law is genuinely unclear, to give the litigants the benefit of the same rule which would be applied to others in the state court. Professor Kurland has written that certification offers "the greatest promise" for resolving troublesome state law questions in a definitive manner, thus better assuring "the equality of treatment which the *Erie* rule was

aimed to accomplish" without the separate lawsuit, delay and expense associated with abstention. Kurland, *Mr. Justice Frankfurter, The Supreme Court and the Erie Doctrine in Diversity Cases,* 67 YALE L. J. 187, 214 (1957).*

As certification avoids the threat of an inconsistent state determination, so it also affords a practical equivalent for something the accident of diversity jurisdiction otherwise takes away—the opportunity for authoritative review of the federal court's state law determination. A state trial court's determination on an important question of unclear state law may normally be tested in its intermediate and, ultimately, in its highest courts. In diversity cases there is no opportunity for such review and even the availability of review in this Court is severely limited by the Court's policy of not disturbing state law determinations made by lower federal courts: *see, e.g., Propper* v. *Clark,* 337 U.S. 472, 486-87 (1949); *Helvering* v. *Stuart,* 317 U.S. 154, 162-63 (1942); *Estate of Spiegel* v. *Commissioner,* 335 U.S. 701, 707-08 (1949). In those situations where authoritative appellate review is most important—situations where, as here, state law on an important question of policy is unclear or non-existent—use of a certification procedure enables the federal court to achieve its purpose of sitting, in effect, as "only another court of the State. * * *" *Guaranty Trust Co.* v. *York,* 326 U.S. 99, 108 (1945).

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* *See also* Note, *Consequences of Abstention by a Federal Court,* 73 HARV. L. REV. 1358, 1368-69 (1960); Kurland, *Towards a Co-Operative Judicial Federalism: The Federal Court Abstention Doctrine,* 24 F.R.D. 481, 489-90 (1960).

B. Certification Is a Protection Against Forum-Shopping

Hanna v. *Plumer,* 380 U.S. 460 (1965), requires uniformity of federal and state law as to any rule which would offer litigants in future cases an incentive to choose the federal over the state forum to litigate their local law claims. The present case presents an extreme example of the way in which a federal court's "state law" decision can create a lasting and even self-perpetuating incentive to future litigants to bring similar cases into the federal courts to avoid the possibility that the state might not follow the federal rule.

In this case, Maryland and Illinois stockholders sued in New York's federal court to enforce a state-law claim on behalf of a Florida corporation. What impelled these plaintiffs to choose a New York federal rather than a Florida state forum (perhaps the existence in New York of *Diamond* v. *Oreamuno,* on which their suit was frankly grounded and which has no counterpart in Florida, together with the Second Circuit's reputation for shaping the law of "tippee" liability) is less important than the effect the Second Circuit's decision in this case will have on the choice of forum of future litigants. Future suits against the "tippees" of Florida corporations are not likely to be brought in Florida's courts, where the law is uncertain or even in Florida's federal courts, since the Fifth Circuit would invoke Florida's certification procedure—such suits will be brought in the Second Circuit, where the corporation's claim against "tippees" has already been upheld. Nor is the benefit of the Second Circuit's rule in this case confined to Florida corporations, for it is evident from a reading of the court's opinion that the ma-

jority would like to and would reach the same result under the law of any other of the 49 states whose highest courts have never passed upon the "precise question" of whether a corporation can recover for "tippee" trading by non-profiting non-fiduciaries. As long as the requirements of diversity jurisdiction can be met—and in derivative litigation diverse stockholders usually can be found—every reason will exist for suits against "tippees" to be brought in the Second Circuit rather than in a state court which might rule the other way. A recent writer seems to take for granted that this case is "Second Circuit law":

> "* * * the major impact of *Schein* will be to give the Second Circuit a new weapon with which to police trading on the stock exchanges located in New York City. Shareholders should have no difficulty tracing trading of large blocs of shares by institutions just prior to public announcements having a major impact upon the stock's price. Once an out-of-state shareholder is located as party plaintiff on behalf of the corporation, the subject trader may be sued in New York by invoking diversity jurisdiction in a common law action based upon the principles of *Schein*." Note, 53 Boston U. L. Rev. 1150, 1159 (1973) (footnote omitted).

To the extent that the articulation by a federal court of a "state" right of action never upheld by the state encourages litigants to bring their cases to the federal courts,*

* We deal here with the forum-shopping which arises from a federal court's creation of a state right of action, but the same consequence ensues where a litigant who is able to invoke the diversity jurisdiction does so to take advantage of a restrictive state rule which the federal court is bound to apply, even though he knows the rule is outmoded and might well be overturned by the courts of his state if now challenged before them. See Note, *How A Federal Court Determines State Law*, 59 Harv. L. Rev. 1299 (1946).

Erie's goal of discouraging the choice of a federal forum to obtain a different rule of law is undercut. It is no attack on the diversity jurisdiction to insist that *Erie's* goal of uniformity be fulfilled, and artificial incentives for choosing the federal forum be reduced, by narrowing the range of uncertain state law as much as practicable. Certification is one desirable method of accomplishing this objective. Had the question of the sufficiency of the complaint in this case been certified to Florida's Supreme Court, and had that court answered the question in the negative, the harmful prospect of a string of Second Circuit cases holding "tippees" liable under "state law" would have been put to rest. By the same token, had Florida's court held that the complaints did state a claim for relief under Florida law, future litigants would have been assured that, from the standpoint of substantive law, they could just as well choose to sue in Florida's state as in New York's federal courts. They might still choose the federal forum, but at least an artificial incentive for that choice would have been removed.

While the right of litigants to avail themselves of the diversity jurisdiction for whatever purpose they choose cannot be questioned, the historic purpose of that jurisdiction—the protection of non-citizens against bias in state courts—does not warrant encouraging use of the federal courts to litigate what are essentially local issues, any more than it justifies incursion by the federal courts into the states' role of making state law. *Snyder* v. *Harris*, 394 U.S. 332, 341 (1969). The federal courts today are flooded with diversity litigation which detracts from their time and resources needed to deal with the federal constitutional

and statutory questions which are their paramount concern. Whichever way Florida answered the question, the federal court system as a whole would have benefited if the Second Circuit had stopped here to determine whether Florida recognizes the claim asserted in this case.

C. Certification Was Required in This Case in the Interests of Comity.

This case presented an important question of common law and an important policy choice for the state of Florida in an area in which state policy is unquestionably supreme, that of defining and regulating the duties of fiduciaries to corporations formed under its law. The Second Circuit decided that question, and made that policy choice, without guidance in Florida's law, by infusing its view of federal securities law policy objectives into the precedent-breaking New York rule of *Diamond*. In so doing, the Second Circuit unnecessarily invaded Florida's interest in remaining the primary expositor of its law.

The "desirability of avoiding unseemly conflict between two sovereignties, [and] the unnecessary impairment of state functions * * *" have long been recognized as among the concerns which may require a federal court to stay its hand. *Martin* v. *Creasy*, 360 U.S. 219, 224 (1959). While abstention, since *Railroad Commission* v. *Pullman Co.*, 312 U.S. 496 (1941), has been most commonly associated with the avoidance of premature constitutional decisions, the author of the *Pullman* decision, dissenting in *Propper* v. *Clark*, 337 U.S. 472 (1949), made it clear that respect for the proper role of the state was equally important to the *Pullman* rationale. Mr. Justice Frankfurter said:

> "It is true that in all but one of these [abstention] cases recourse to the State courts also served the purpose of avoiding what might have been an unnecessary decision of a constitutional issue. * * * Even more fundamental, however, was recognition of the importance of maintaining harmonious relations between parallel systems of State and federal courts in a situation where, because State law controlled, the State courts had the last word and so a federal court at best could make only an informed guess. That this was a dominant consideration in the mind of the Court appears plainly in the language of its opinions." 337 U.S. at 494-95.

He concluded:

> "So here, though no constitutional issue is present, regard for the respective orbits of State and federal tribunals is the best of reasons, as a matter of judicial administration, for requiring a definitive adjudication by the New York courts rather than proceeding on the basis of our own tentative guess as to the meaning of the New York statutes." 337 U.S. at 497.

The importance of avoiding "needless friction with state policies" was the primary reason for abstention in *Chicago* v. *Fieldcrest Dairies*, 316 U.S. 168, 172 (1942). That case involved the possible conflict between a state statute and a city ordinance regulating the form of milk containers, an issue on which the Supreme Court of Illinois had the final word. The constitutional issue, if not insubstantial, was very much in the background. Mr. Justice Douglas' opinion for the Court rested squarely on the ground of comity:

> "Considerations of delay, inconvenience and cost to the parties, which have been urged upon us, do not

> call for a different result. For we are here concerned with the much larger issue as to the appropriate relationship between federal and state authorities functioning as a harmonious whole." 316 U.S. at 172-73.

See also Louisiana Power & Light Co. v. *Thibodaux*, 360 U.S. 25, 29 (1959); *Kaiser Steel Corp.* v. *W. S. Ranch Co.*, 391 U.S. 593 (1968).

A state's policy can be disturbed in other ways than by an injunction against its officers or a declaration that a statute is unconstitutional. The instant case is an example of just such interference, for in this case a "state" right of enormous impact has been created for Florida by a distant federal court whose deference to Florida law and policy was no more than formal. The opportunity of Florida's Supreme Court to correct the Second Circuit's error (as we believe it was) in a future case does not make up for the intrusion into her affairs represented by this decision. That opportunity, moreover, as a result of the Second Circuit's decision is more fiction than fact, since future plaintiffs have every reason to bring their claims to the federal courts of the Second Circuit rather than to Florida which might not sustain them. Florida's Legislature, by enacting the certification procedure, expressed its distaste for having important questions of Florida law decided by the federal courts and at the same time offered to relieve the federal courts of that difficult task.* The Second Circuit should have respected Florida's preference.

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* According to a Florida commentator, Florida's adoption of the certification procedure in 1945 was "probably a reaction" to this Court's decision in *Meredith* v. *City of Winter Haven*, 320 U.S. 228 (1943). Note, *Florida's Interjurisdictional Certification: A Re-examination to Promote Expanded National Use*, 22 U. FLA. L. REV. 21, 27 (1969).

Harmony in federal-state relations means more, in any event, than the mere avoidance of gratuitous interference with state policy, and certification is a better means than abstention for achieving the larger goal of what has been termed "cooperative judicial federalism", making the best use of the "special expertise of each of two judicial systems" while at the same time "[economizing] on the use of the systems so that one lawsuit will suffice to dispose of the problem rather than permitting two with the possibility of conflicting results as well as multiple costs." Kurland, *Toward a Co-Operative Judicial Federalism: The Federal Court Abstention Doctrine*, 24 F.R.D. 481, 487 (1959); *see also* Hufstedler, *Comity and the Constitution: The Changing Role of the Federal Judiciary*, 47 N.Y.U. L. Rev. 841, 867 (1972). Its use here would have been especially appropriate, for here, as in *Moragne* v. *States Marine Lines, Inc.*, 398 U.S. 375 (1970), the very fact that federal statutory policy may have overlapping concerns makes it all the more important that the state issue not be decided by looking through the federal lens.

D. Certification Is a Better Answer Than Abstention to the Unclear State Law Problem.

This Court has repeatedly held that abstention, as an escape from the duty of a federal court to decide a case properly before it, is appropriate only in narrowly-defined special circumstances which justify "the delay and expense to which application of the abstention doctrine inevitably gives rise," *England* v. *Louisiana State Board of Medical Examiners*, 375 U.S. 411, 418 (1964); *see also Kusper* v. *Pontikes*, 94 S. Ct. 303, 306 (1973); *Lake Carriers' Association* v. *MacMullan*, 406 U.S. 498, 509 (1972). Recognizing

that both the impairment of federal jurisdiction and the delay and expense associated with abstention are substantially alleviated when a certification procedure is available, many commentators have urged the states to enact such legislation as a means of reducing the costs of abstention decisions.* Mr. Justice Douglas, dissenting in *England*, suggested certification as a means of making abstention decisions less cumbersome:

> "Another alternative is for the District Court to follow the certificate route, when one is available. The Florida Supreme Court is authorized to provide by Rule for answering certificates concerning state law questions tendered by the federal courts. We use that procedure on Florida state law perplexities [citations omitted]. We cannot require the States to provide such a procedure; but by asserting the independence of the federal courts and insisting on prompt adjudications we will encourage its use." 375 U.S. at 433-34 (footnote omitted).

Certification is a valuable tool for assisting the federal courts in their task of finding and applying state law, and there is no reason to confine its use to cases in which abstention would otherwise be necessary. Its use should

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* *See, e.g.*, Note, *Certifying Questions to State Supreme Courts: As a Remedy to the Abstention Doctrine*, 9 S. DAK. L. REV. 158 (1964); Note, *Inter-Jurisdictional Certification: Beyond Abstention Toward Cooperative Judicial Federalism*, 111 U. PA. L. REV. 344 (1963).

Five states besides Florida now have certification procedures: HAWAII REV. STAT. §§602-36, 37 (1968); ME. REV. STAT. ANN. tit. 4, §57 (Supp. 1970); ME. R. CIV. P. 76B; MONT. SUP. CT. R. 1; N.H. REV. STAT. ANN. ch. 490; APP. R. 21, §1 (1968); WASH. REV. CODE ANN. ch. 2.60.020 (Supp. 1969). The National Conference of Commissioners on Uniform State Laws has recommended, and the American Bar Association has recommended enactment of all states of a Uniform Certification procedure: UNIFORM CERTIFICATION OF QUESTIONS OF LAW [ACT] [RULE].

be sanctioned whenever state law on a significant question appears truly unclear or non-existent, and should be required in those infrequent cases where, as here, the federal court's alternative is to abandon state law altogether.

1. Certification Does Not Deprive Any Litigant of a Federal Forum.

Meredith v. *City of Winter Haven*, 320 U.S. 228 (1943), was a suit by non-citizen bondholders attacking the validity of the city's plan to retire a bond issue without payment of deferred interest coupons. The District Court dismissed the complaint for failure to state a claim and because the controlling state law question had been decided adversely to similarly-situated bondholders by the Supreme Court of Florida in another case. The Fifth Circuit was of the view that Florida law was uncertain, apparently because it thought Florida might not adhere to its prior decision, and directed that the complaint be dismissed without prejudice to the rights of the parties to bring a declaratory judgment suit in Florida. This Court reversed, saying:

> "While the rulings of the Supreme Court of Florida in the *Andrews* case must be taken as controlling here unless it can be said with some assurance that the Florida Supreme Court will not follow them in the future (citation omitted), we assume, as the Court of Appeals has indicated, that the Supreme Court of the State may modify or even set them aside in future decisions. But we are of the opinion that the difficulties of ascertaining what the state courts may hereafter determine the state law to be do not in themselves afford a sufficient ground for a federal court to decline to exercise its jurisdiction to decide a case which is properly brought to it for decision." 320 U.S. at 234.

Insofar as *Meredith* holds that a federal court may not close its doors because of the mere prospect that a state court might change its rule in the future, its validity today is unquestioned, for this Court has consistently recognized that the first requisite of abstention is an issue of genuinely unclear state law. *See, e.g., Allegheny* v. *Frank Mashuda Co.*, 360 U.S. 185, 186 (1959); *Harman* v. *Forssenius*, 380 U.S. 528, 534-36 (1965). Nor do we suggest that certification is appropriate in a case where state law can be determined from existing precedent, as the Fifth Circuit has recognized: *Greer* v. *Associated Indemnity Co.*, 371 F.2d 29, 30 (5th Cir. 1967); *Vandercook & Son, Inc.* v. *Thorpe*, 344 F.2d 930, 931 (5th Cir. 1965).

It cannot be supposed, however, that *Meredith* limits a federal court's use of Florida's certification procedure to cases in which abstention would otherwise be necessary. No such limitation was expressed by the Court in *Clay* v. *Sun Insurance Office, Ltd.*, 363 U.S. 207 (1960), when it suggested that the Fifth Circuit resolve its Florida law dilemma by use of the certification procedure. In *Aldrich* v. *Aldrich*, 375 U.S. 249 (1963), and *Dresner* v. *Tallahassee*, 375 U.S. 136 (1963), this Court used the certification procedure simply as a tool for finding Florida law, as the Fifth Circuit has done in recent years to resolve a variety of Florida questions which, had the certification procedure not been available, would probably have been decided by the court without abstention. *See, e.g., Green* v. *American Tobacco Co.*, 325 F.2d 673 (5th Cir. 1963); *Hopkins* v. *Lockheed Aircraft Corp.*, 394 F.2d 656 (5th Cir. 1968).

Implicit in this Court's and the Fifth Circuit's use of certification as a tool for finding Florida law is a recognition

that certification does not, as did the form of abstention the Court refused to countenance in *Meredith,* require the federal court to refuse to entertain an action properly before it. Nor does certification result, as have most abstention decisions in recent years, in sending the parties to the state courts for separate adjudication of so much of their dispute as involves state claims.

In *England* v. *Louisiana State Board of Medical Examiners,* 375 U.S. 411, 415 (1964), this Court said that there were "fundamental objections" to any conclusion that a litigant having properly invoked the federal court's jurisdiction could be compelled to accept a state court's determination of his claims instead. Review from the state decision, this Court held, was not an adequate substitute for "the benefit of a federal trial court's role in constructing a record and making fact findings." 375 U.S. at 416. Florida's certification procedure fully accomplishes *England's* mandate.* The federal district court remains the trier of fact and the source of the initial decision. The Court of Appeals, if it finds the district court's decision to have been controlled by a question of unclear Florida law, can certify that question directly to Florida's Supreme Court. The submission by a federal Court of Appeals of a question of law, framed by it on stated facts—or in this case, on the allegations of a complaint—is scarcely a surrender of federal judicial authority, for the state and not the federal court has the primary interest in deciding that question in the first place, and the litigant seeking to en-

* *See* Liebenthal, *A Dialogue on England: The England Case, Its Effect on the Abstention Doctrine, and Some Suggested Solutions,* 18 W. Res. L. Rev. 157, 201 (1966).

force a state-created right in the federal court is entitled to no more than the rule of law which would be applied by the state.

2. *The Benefits of Certification Outweigh the Small Amount of Delay and Expense It Adds to the Proceeding.*

In the usual abstention case, the parties are directed to commence a state declaratory judgment or other action to obtain a determination of the uncertain state question. Members of this Court have frequently protested the multiplied costs, and the protracted delay, which can result from this procedure. *See, e.g., Harrison* v. *NAACP,* 360 U.S. 167, 180 (1959) (dissenting opinion of Mr. Justice Douglas). Certification is not, of course, free from delay or expense. The added expense, however, is not that of a separate lawsuit, but rather of an extra set of briefs. The added delay is not the years which may be consumed in starting a separate suit and having it proceed through the state's trial and appellate courts, but the months which are typically required to obtain an answer directly from the state's highest court. The Fifth Circuit has commended the efficiency with which Florida's Supreme Court answers questions certified to it: *Martinez* v. *Rodriques,* 410 F.2d 729 (5th Cir. 1969); *National Education Ass'n, Inc.* v. *Board of Public Instruction,* 467 F.2d 447, 449 (5th Cir. 1972). A detailed study of the time consumed by certification procedures, *The Case For Certification,* 12 Wm. & Mary L. Rev. 627, 647 (1971), demonstrates that Florida, which has more experience than other states with this procedure, by 1969 and 1970 had reduced the average time consumed in furnishing answers to certified questions to 221

days, or some seven months. The cost of a seven-month delay, in an appropriate case, is well worth the benefits received.

Conclusion

The Second Circuit Court of Appeals' decision in this case should be reversed and the Court of Appeals should be directed upon remand to certify the controlling question of law presented herein to the Supreme Court of Florida.

Dated: New York, New York
January 17, 1974

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IN THE

Supreme Court of the United States

OCTOBER TERM 1973

No. 73-495

INVESTORS DIVERSIFIED SERVICES, INC., INVESTORS VARIABLE PAYMENT FUND, INC. and IDS NEW DIMENSIONS FUND, INC.,
Petitioners,

v.

JACOB SCHEIN and MARVIN H. SCHEIN,
Respondents.

INVESTORS DIVERSIFIED SERVICES, INC.,
Petitioner,

v.

ANTONE F. GREGORIO,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONERS

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Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONERS

This brief is submitted on behalf of petitioners Investors Diversified Services, Inc. (hereafter "IDS"), and Investors Variable Payment Fund, Inc., and IDS New Dimensions Fund, Inc. (hereafter "the funds"). Petitioners ask reversal of a decision of the United States Court of Appeals for the Second Circuit, which reversed the dismissal of these actions by the United States District Court for the Southern District of New York.

Opinions Below

The opinions of the Court of Appeals, reported at 478 F.2d 817, and the opinion of the District Court, reported at 335 F.Supp. 329, appear in the appendix (61a, 50a).

Jurisdiction

The judgment of the Court of Appeals was entered on May 10, 1973, and a timely petition by these petitioners for rehearing with a suggestion for rehearing in banc was denied on June 18, 1973. A timely petition for certiorari, filed on September 17, 1973, was granted on December 3, 1973. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

Question Presented

Did the Court of Appeals for the Second Circuit err in not certifying questions of Florida law to the Florida Supreme Court pursuant to Florida's certification procedure? 1A Fla. Stat. Ann. Sec. 25.031, 25.032 (1961), Fla. App. Rules, R.4.61 (1967).

Statutes Involved

Florida Annotated Statutes, § 25.031, provides:

> "The supreme court of this state may, by rule of court, provide that, when it shall appear to the supreme court of the United States, to any circuit court of appeals of the United States, or to the court of appeals of the District of Columbia, that there are involved in any proceeding before it questions or propositions of the laws of this state, which are determinative of the said cause, and there are no clear controlling precedents in the decisions of the

supreme court of this state, such federal appellate court may certify such questions or propositions of the laws of this state to the supreme court of this state for instructions concerning such questions or propositions of state law, which certificate the supreme court of this state, by written opinion, may answer."

Florida Annotated Statutes, § 25.032, provides:

"The supreme court of this state is hereby authorized and empowered to collaborate with any and all other courts of last resort, of other states and of the United States, in the preparation and approval of uniform rules of court to make effective this and similar laws."

Florida Appellate Rule 4.61, promulgated by the Supreme Court of Florida, provides:

Rule 4.61. CERTIFIED QUESTIONS FROM FEDERAL COURTS

a. When certified. When it shall appear to the Supreme Court of the United States, or to any of the Courts of Appeal of the United States that there are involved in any proceeding before it questions or propositions of law of this state which are determinative of said cause and that there are no clear controlling precedents in the decisions of the Supreme Court of this state, such federal appellate court may certify such questions or propositions of law of this state to the Supreme Court of Florida for instructions concerning such questions or propositions of state law.

b. Jurisdiction. Questions or propositions of law referred to in sub-paragraph a. hereof shall be certified for answer to the Supreme Court of this state.

c. Method of Invoking Rule. The provisions of this rule may be invoked by any of the federal courts referred to in sub-paragraph a. hereof upon its own motion or upon the suggestion or motion of any interested party when approved by such federal court.

d. Contents of Certificate. The certificate provided for herein shall contain the style of the case, a statement of facts showing the nature of the cause and the circumstances out of which the questions or propositions of law arise and the question of law to be answered.

e. Preparation of Certificate. The certificate may be prepared by stipulation or as directed by such federal court. When prepared and signed by the presiding judge of said federal court, it shall be certified to the Supreme Court by the Clerk of the Supreme Court by the Clerk of the federal court and under its official seal. The Supreme Court may, in its discretion, require the original or copies of all or any portion of the record before the federal court to be filed with said certificate where, in its opinion, such record may be necessary in the determination of said cause.

f. Costs of Certificate. The costs of the certificate and filing fee shall be equally divided between the parties unless otherwise ordered by this Court.

g. Briefs and Argument. The appellant or moving party in the federal court shall file and serve upon its adversary its brief on the question certified within 30 days after the filing of said certificate in the appellate court of this state having jurisdiction. The appellee or responding party in the federal court shall file and serve upon its adversary its brief within 20 days after the receipt of appellant's or moving party's brief and a reply brief shall be filed within 10 days thereafter.

h. Oral Argument. Oral argument may be granted upon application and, unless for good cause shown the time be enlarged by special order of the Court prior to the hearing thereon, the parties shall be allowed the same time as in other causes on the merits.

Statement of the Case

These petitioners are named as defendants in stockholders' derivative actions brought on behalf of Lum's, Inc. (hereafter "Lum's"), a Florida corporation. The complaints assert no claim under federal law; jurisdiction is founded solely on diversity of citizenship.

The complaints allege, in substance, that the chief executive officer of Lum's imparted to an employee of Lehman Brothers confidential corporate information, prior to any public announcement, that the earnings of Lum's would be lower than those previously announced. It is alleged that through the Lehman representative this information came to two employees of IDS who were portfolio managers of the funds,* and that they caused the funds to sell stock of Lum's at a higher price than that to which the price dropped when the information was announced to the public.

The *Schein* complaint asserts that petitioners "are liable to Lum's for their unlawful profits (including commissions) and are liable to Lum's for the damages it sustained thereby" (20a, ¶ 25). The *Gregorio* complaint seeks to require petitioners to account to Lum's for profits, but does not allege that Lum's sustained any damage (30a, ¶ 22).

These petitioners and other defendants moved under F.R.C.P. 12(b)(6) to dismiss the complaints for failure to state a claim on which relief can be granted. The plain-

* IDS acts as the investment advisor to the funds.

tiffs at first urged that New York substantive law applied, but they later conceded the applicability of Florida law. Judge Tyler of the District Court dismissed the complaints.

Judge Tyler found no Florida Supreme Court precedent in point, but noted that lower Florida courts had held that a stockholder's derivative complaint must allege some damage to the corporation. Since in the *Schein* case there was a conclusory allegation of damage, and since a Florida court might consider the law of other states, Judge Tyler proceeded to examine the sufficiency of the complaints in the light of a New York case which the plaintiffs urged as support, *Diamond* v. *Oreamuno,* 24 N.Y. 2d 494, 248 N.E. 2d 910 (1969).

The *Diamond* case, admittedly without precedent, upheld a complaint in a derivative action seeking recovery of profits from corporate directors made by their selling stock on the basis of inside information. Judge Tyler held that the complaints in these actions as against these petitioners went beyond the rationale of *Diamond*, which centered on the fiduciary duties of the defendants there, because IDS and the funds owed no "fiduciary duties whatsoever to [Lum's]" (55a).

On appeal, the Court of Appeals reversed in a 2-1 decision, and found the complaints sufficient. The majority opinion, by Judge Waterman, said there was no Florida precedent, but turned to New York law and the *Diamond* case, and said that the question was whether the holding of that case "should extend to reach third parties" who were "involved with directors in a common enterprise" (67a). The majority said that *Diamond* "has the prophylactic effect of providing a disincentive to insider trading" which "ought to reach third parties," and held that it should be so extended, closing with a number of citations of federal

securities law cases finding violations of federal law in the use of inside information (73a).

A dissenting opinion, by Judge Kaufman, agreed that profiting by insider trading was reprehensible, but said that the majority had made "an extraordinary, expansive, and incorrect reading of New York law" (74a) and had substituted "its own view of what state law ought to be, for what the state law actually is" (80a). He noted that private and government suits under federal law provided full remedies to purchasers of stock (73a-75a), but that this did not mean that *"under state common law,* tippee trading is a breach of fiduciary duty owed to the corporation whose shares are traded," which is remediable in a shareholder's derivative action (79a).

He further noted that there was not even an allegation that the petitioners concocted a prearranged scheme, which would be a prerequisite to suit based on the "common enterprise" theory embraced by the majority.

Concluding, Judge Kaufman said (80a-81a) that he failed to comprehend why the majority refused to utilize Florida's certified question statute (pp. 2-3, *supra*), providing for certification to the Florida Supreme Court by a federal court of an unresolved question of Florida law determinative of a case before it, on which there are no clear, controlling Florida Supreme Court precedents.

Whether it was error not to have used this Florida procedure for certification is the question as to which this Court has granted certiorari.

ARGUMENT

The Problem of Uncertainty of State Law in Federal Diversity Cases

In *Erie R.R.* v. *Tompkins*, 304 U.S. 64 (1938), the Court held that the federal courts in diversity cases are constitutionally bound to follow the common law of the appropriate state rather than any "federal general common law." Where state common law is clear from state precedents, this may not be difficult, but there has been a recurrent problem as to how to deal with cases where there is no precedent. This is such a case.

Both lower courts agreed that the governing law as to whether the complaints state a claim is that of Florida, and that the question determinative of the sufficiency of the complaints has never been decided by a Florida court. The duty of a federal court in a case like this one, brought in New York and with the applicable law that of another state, was aptly described by Judge Friendly in *Nolan* v. *Transocean Air Lines*, 276 F.2d 280, 281 (2d Cir. 1960), as follows:

> "Our principal task, in this diversity of citizenship case, is to determine what the New York courts would think the California courts would think on an issue about which neither has thought."

The *Nolan* case involved an attempt to determine the answer to a question of the applicability of a California statute of limitations, and the Second Circuit based its holding on decisions of intermediate California appellate courts. Subsequently, this Court remanded the case (365 U.S. 293 (1960)) for consideration of whether the New York Court of Appeals would have decided otherwise on the basis of a dictum in a later California Supreme Court

case. On the remand, the Second Circuit adhered to its original decision, but bemoaned the absence of procedure which would permit the apparent conflict to be "settled by the only court that can authoritatively determine it"—namely the California Supreme Court. 290 F.2d 904, 905 (2d Cir. 1961).

In the instant case, such a procedure was available through the Florida certification statute and rule which would permit an authoritative determination by the Florida Supreme Court. The Court of Appeals, however, paid only lip service to its duty, undertook no analysis of the policy or decisional law of Florida, and did not use the certification procedure, but speculated on Florida law by extending an unprecedented New York decision beyond its limitations.

This case is precisely the kind with which the Florida statute and rule providing for federal appellate court certification of a question of Florida law to the Florida Supreme Court was designed to deal. We submit that it was clear error not to utilize the procedure.

The Duty to Decide Uncertain State Questions and Abstention as a Possible Course

This Court has treated in different ways the problem faced by federal courts in diversity cases where a controlling question of state law has not been decided by state courts. On the one hand, the Court has held that dismissal of a complaint without prejudice to proceeding in a state court, on the ground that applicable state law is not clearly settled, is not proper, because the federal courts have a duty to decide the question of state law. *Meredith* v. *Winter Haven*, 320 U.S. 228 (1943). On the other, abstention by lower federal courts from deciding a question until after determination of a state law question in a state court

proceeding, pending or to be brought, has been directed or approved. See, e.g. *Railroad Commission* v. *Pullman Co.*, 312 U.S. 496 (1941); *Louisiana Power & Light Co.* v. *Thibodaux City*, 360 U.S. 25 (1959); *Kaiser Steel Co.* v. *W. S. Ranch Co.*, 391 U.S. 593 (1968).

A common case for abstention is one where there may be a state court interpretation of a state statute which may avoid a federal constitutional question. E.g., *Lake Carriers' Association* v. *MacMullan*, 406 U.S. 498, 510-11 (1972). Other situations have also been held to justify abstention. In general, the Court has upheld it in cases where there might be interference with a state policy by a federal court decision. E.g., *Chicago* v. *Fieldcrest Dairies, Inc.*, 316 U.S. 168 (1942); *Thompson* v. *Magnolia Petroleum Co.*, 309 U.S. 478 (1940); *Martin* v. *Creasy*, 360 U.S. 219, 224 (1959).

The question of law involved in this case is certainly one that involves the policy of the State of Florida as to Florida corporations. Whether Florida wishes to adopt the rule of the *Diamond* case, which appears to be unprecedented in New York,* so as to permit a Florida corporation to recover damages in a derivative suit against corporate fiduciaries when the corporation has not actually been damaged in any traditional sense, is a question of policy. And whether Florida wants to extend that rule to allow recovery against non-fiduciary stockholders who have traded on the basis of inside information is even more a policy question which should be decided by a Florida court.

Judge Kaufman's dissent noted (78a, fn. 3) the unlikelihood that New York itself would have made such an extension. He pointed out that the New York Appellate Division in the *Diamond* case had affirmed dismissal of

*As was noted by Judge Fuld in *Diamond*, 24 N.Y. 2d at 500, 248 N.E. 2d at 913.

the complaint against directors—fiduciaries—who had "approved, acquiesced in or ratified" the transactions involved, but had not profited.

Judge Tyler had no way to refer the question to the Florida court, since the procedure for certification under the Florida statute and rule is open only to a federal appellate court. Since he could not himself put the issue to a Florida court, he was not wrong in obeying the mandate of *Meredith* v. *Winter Haven, supra,* that it is the duty of federal courts in diversity cases to decide state law questions, no matter how difficult and uncertain a decision may be.

The Second Circuit's Error in Not Using Certification

When the case reached the Second Circuit, the possibilities were different. Instead of attempting to engraft upon Florida law an unprecedented new rule, the Court of Appeals could and should have obtained a decision from the highest court of Florida by certification. This would have involved abstaining only for the length of time required for presentation and decision of the question in the Florida Supreme Court.

The majority in the Court of Appeals may be said to have disregarded the rule of *Erie R.R.* v. *Tompkins, supra,* by, in effect, adopting for Florida a "federal common law" and as Judge Kaufman noted in dissent, substituting "its own view of what state law ought to be for what the state law actually is" (80a). Judge Kaufman recognized and agreed with the view that the use of inside corporate information as a motivation for stock dealings is reprehensible, but disagreed that Florida law provides a cause of action to the corporation whose shares were traded. Federal courts, interpreting and applying federal securities statutes, have expanded the scope of liability of partici-

pants in such activity to those damaged by it, and the majority below relied largely on such expansive precedents, in justifying its "stretch" of the *Diamond* case. In so doing it ignored the fact that under *Erie* it was the court's duty to apply *Florida* law, and that the Florida courts might or might not feel that the corporate law of that state should be applied to have "the prophylactic effect of providing a disincentive to insider trading" (69a).

The question which the Court has posed by the grant of certiorari relates to a Florida statute. It has always been the law, even prior to *Erie*, that in a diversity case a state statute on a substantive question must be given effect by a federal court. While the Florida statute here involved is not substantive it clearly expresses a Florida policy of preferring that questions of Florida substantive common law should not be the subject of speculation by the federal judiciary and, in the absence of "clear controlling precedents," such questions should be decided by the Florida Supreme Court through certification. That policy should have been given effect here by the Court of Appeals, through certification to the Florida Supreme Court.

Abstention and Its Disadvantages

A situation in which a federal court's interpretation of state law is subsequently rejected by state courts is obviously unfortunate, but is not rare. In a dissenting opinion in *W. S. Ranch Co.* v. *Kaiser Steel Corp.*, 388 F.2d 257 (10th Cir. 1967), Judge Brown in the Tenth Circuit, urging federal court abstention pending a state court determination, collected (388 F.2d at 264-65, notes) a large number of examples of such rejections.

Judge Brown's view was adopted by this Court, which ordered abstention *per curiam*. *Kaiser Steel Corp.* v. *W. S. Ranch Co.*, 391 U.S. 593 (1968). Abstention, in the

absence of a certification procedure, is not always a wholly satisfactory solution. It may require the institution of new state court litigation, frequently by way of declaratory judgment action, in the lower courts. The delay and expense of independent state litigation, including appellate procedures to obtain review in the state's highest court, are undesirable consequences. And the result, realistically, may be to deprive the parties of the right conferred by diversity jurisdiction to have the litigation determined under federal procedure. It has been noted that abstention may deny the right to have the facts found by a federal court. Cf. *England* v. *Louisiana State Board of Medical Examiners,* 375 U.S. 411, 415-17 (1964).

Advantages of Certification

The problems of abstention are largely avoided by certification. The federal court may frame the legal question to which it needs an answer, and may submit it directly to the highest state court, which can give a reasonably prompt answer. The federal court retains control of the basic litigation, and resolves all other questions.

The Florida certification statute and rule as a solution to the difficulties of federal court determination of state law questions has been widely praised and used. This Court has itself employed the procedure in three cases. *Clay* v. *Sun Insurance Office, Ltd.,* 363 U.S. 207 (1960); *Dresner* v. *City of Tallahassee,* 375 U.S. 136 (1963); *Aldrich* v. *Aldrich,* 375 U.S. 75 (1963). The Fifth Circuit, within whose boundaries Florida is situated, has frequently resorted to certification in cases involving Florida law. Numerous instances are collected in *Boyd* v. *Bowman,* 455 F.2d 927, note 1 (5th Cir. 1972). The Fifth Circuit has repeatedly extolled the virtues of the practice as avoiding guesswork as to what the Florida Supreme Court would hold. E.g., *Hopkins* v. *Lockheed Aircraft Corp.,* 394 F.2d

656, 656-57 (5th Cir. 1958); *Martinez* v. *Rodriguez*, 410 F.2d 729, 730, 731, note 5 (5th Cir. 1969). The opinion in the latter case also praised the promptness with which the Florida Supreme Court has acted (410 F.2d at 731, note 7).

This Court has on occasion indicated a view that it should leave undisturbed determinations of doubtful questions of state common law when they are made by courts of appeals which are constantly required to deal with such questions relating to states within their geographical areas. *Estate of Spiegel* v. *Comm'r*, 335 U.S. 701 (1949). This emphasizes the particular value of resort to certification, where it is available, by a federal court required to interpret the law of a state remote from its boundaries, as was the case with the Second Circuit in dealing with Florida law.

The problem of federal determination of state law, and the solutions of abstention and certification, have been the subject of many law review comments. Although doubts have been expressed about abstention pending independent state litigation, as an avoidance of federal court responsibility, the certification procedure has often been commended by writers. See, e.g., Gowen & Izlar, *Federal Court Abstention in Diversity of Citizenship Litigation*, 43 Tex. L. Rev. 194, 209-10 (1964); Note, *Inter-Jurisdictional Certification: Beyond Abstention Toward Cooperative Judicial Federalism*, 111 U. Pa. L. Rev. 344, 350 (1963); Vestal, *The Certified Question of Law*, 36 Iowa L. Rev. 629, 644-45 (1951); Kurland, *Mr. Justice Frankfurter, The Supreme Court and the Erie Doctrine in Diversity Cases*, 67 Yale L.J. 187, 214 (1957); Note, *Abstention and Certification in Diversity Suits: "Perfection of Means and Confusion of Goals,"* 73 Yale L.J. 850, 867-69 (1964); Lillich and Mundy, *Federal Court Certification of Doubtful State Law Questions*, 18 U.C.L.A. L. Rev. 888 (1971); Note, *Louisiana Power & Light* v. *Thibodaux: The Abstention Doctrine Expanded*, 69 Yale L.J. 643 (1960); and Note, *Federal*

Abstention and Its Relation to the Erie Doctrine, 38 Temp. L.Q. 72 (1964).

The National Conference of Commissioners on Uniform State Laws has recommended a proposed Uniform Certification of Questions of Law Act or Rule for the certification of questions of law between jurisdictions, and the American Bar Association has approved the recommendation. The procedure is specifically directed to the problem under *Erie R.R.* v. *Tompkins, supra,* of ascertaining state law when it is doubtful, and the proposed Uniform Rule is patterned in large measure on Florida Appellate Rule 4.61, *supra,* p. 3.

The American Law Institute has also approved a codification of certification by federal courts to the highest state courts of questions of law. *ALI, Study of the Division of Jurisdiction Between State and Federal Courts,* § 1371(e) p. 50 (1969). Again, the proposal is broad, and the advantages of certification over abstention are noted (pp. 292-296).

The Florida statute and rule appear to be the prototype of certification procedures. There are, however, at least nine other states which have provided for it. Colorado: Rule 21.1, Appellate Rules; Hawaii: Rev. Stat. § 602-36; Louisiana: Rev. Stat. Ann. 13, § 13.72.1; Maine: Rev. Stat. Ann., Tit. 4, § 57; Maryland: Ann. Code, Art. 26, § 161; Massachusetts: Supreme Judicial Court Rules, R.3:21; Montana: Rule 1, Rules of the Montana Supreme Court; New Hampshire: Rev. Stat. Ann. § 490; Washington: Rev. Code Ann. § 2.60. There are reported cases of the utilization of certification in five of these states.*

* The First Circuit has used the New Hampshire procedure, *Ford* v. *Blue Mountain Tramways, Inc.,* 110 N.H. 20, 259 A.2d 129 (1969). In Maine, Washington, Montana and Maryland, where certification may be asked by federal district courts, they have done so. *Pierce* v. *Secretary,* 254 A.2d 46 (Me. 1969); *Norton* v. *Benjamin,* 220 A.2d 248 (Me. 1966); *In re Richards,* 223 A.2d 827 (Me. 1966); *In re Elliott,* 74 Wash. 2d 600, 446 P.2d 347 (1968); *Irion* v. *Glens Falls Ins. Co.,* 154 Mont. 156, 461 P.2d 199 (1969). *Smith* v. *Gray Concrete Pipe Co., Inc.,* 267 Md. 149, 297 A.2d 721 (1972).

Summary of the Importance of This Case and of Encouragement of Certification

The question presented by this case is a narrow but important one. Its importance arises out of the responsibilities which diversity jurisdiction places on the federal courts. The *Erie* case made it clear that those responsibilities require federal court determination of state common law rather than creation of some general common law. And *Meredith* v. *Winter Haven,* supra, held that the responsibility cannot be avoided by federal refusal to decide questions of state law because the answers are not clearly settled by state precedents.

Nevertheless, a dilemma of diversity jurisdiction is that a federal court determination of undecided state law may prove to be contrary to what state courts later decide is state policy. One solution to the dilemma—federal court abstention from decision until the question of state law has been decided in independent pending or potential litigation in the state courts—frequently results in delay and expense, and may deprive litigants of rights to which federal diversity jurisdiction entitles them.

A preferable solution which, as we have seen, a number of states and notably Florida have made possible is certification by the federal courts to the highest state courts of legal questions pursuant to state statutes or rules. The states which have adopted such procedures have thereby indicated their preference that questions of state law be determined by state courts, and their willingness to cooperate in aiding the federal judiciary to this end.

The general approbation of certification has been noted. Unless the procedure is used by the federal courts, however, it has no value. Its frequent use will encourage other states to adopt statutes and rules authorizing it. The desirability of this was recognized in a concurring opinion in *England*

v. *Louisiana State Board of Medical Examiners, supra,* by Justice Douglas, who said:

> "We cannot require the States to provide such a procedure; but by asserting the independence of the federal courts and insisting on prompt adjudications we will encourage its use" (375 U.S. at 433-34).

This is an ideal case for the Court to encourage the use of certification and its broader adoption. What the two-judge majority of the Court of Appeals did here is a perfect example of the potentially unfortunate results of speculation by a federal court on an undecided state law question, rather than obtaining a definitive state determination by certification. In relying for Florida law on a New York precedent which itself was a departure from any prior case, deciding that the "stretch" of *Diamond* (68a) reached these petitioners, and admittedly expanding it beyond what New York has decided, the Court of Appeals undertook to decide on Florida policy, which it is neither equipped nor entitled to do. To permit the decision to stand, with the majority's heavy emphasis upon policies enunciated in federal precedents under federal statutes rather than focusing on "the strands of duty running to the corporation from the various individuals involved" (75a) in the alleged breach of common law fiduciary duty, would be to encourage a return to "federal general common law." If Florida wishes to embrace such policies as a matter of Florida corporate law, it can do so upon certification, but it may have a different desire.

The Clarity of This As a Case for Certification

There may be instances where it may not be clear to a federal court that, in the words of the Florida statute, "there are involved in any proceeding before it questions or propositions of the laws of [Florida], which are deter-

minative of the said cause, and there are no clear controlling precedents in the decisions of the supreme court of this state . . . ." This, however, is not such a situation. Both the District Court and the Court of Appeals recognized that whether Florida law permitted the claims asserted against these petitioners was determinative, and both recognized that not only were there no "clear controlling precedents," but that there were no precedents.

It is not necessary for the Court to hold that in every situation where it is suggested that there is doubt as to state law, and where a certification procedure is available, the procedure must be employed. We urge, however, that certification should be mandated when state law on a determinative question which involves policy is wholly lacking.

Conclusion

The decision of the Court of Appeals for the Second Circuit should be reversed, and the case remanded to that court with a direction to certify to the Supreme Court of Florida an appropriately worded question or questions for the purpose of determining whether the complaints state a claim on which relief may be granted under Florida common law.

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FEB 19 1974
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IN THE

Supreme Court of the United States

OCTOBER TERM 1973

No. 73-439

LEHMAN BROTHERS, *Petitioner,*

v.

JACOB SCHEIN, MARVIN H. SCHEIN, ANTONE F. GREGORIO, *et al.* *Respondents.*

No. 73-440

BENJAMIN SIMON, *Petitioner, et al.,*

v.

JACOB SCHEIN and MARVIN H. SCHEIN, *Respondents.*

No. 73-495

INVESTORS DIVERSIFIED SERVICES, INC., INVESTORS VARIABLE PAYMENT FUND, INC. and IDS NEW DIMENSIONS FUND, INC., *Petitioners,*

v.

JACOB SCHEIN and MARVIN H. SCHEIN, *Respondents.*

INVESTORS DIVERSIFIED SERVICES, INC., *Petitioner,*

v.

ANTONE F. GREGORIO, *Respondent.*

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENTS

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IN THE

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OCTOBER TERM 1973

No. 73-439

LEHMAN BROTHERS,

Petitioner,

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ANTONE F. GREGORIO,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENTS

Opinions Below

The opinion of the Court of Appeals is reported at 478 F.2d 817 (2nd Cir. 1973). The opinion of the District Court is reported at 335 F. Supp. 329 (S.D.N.Y. 1971).

Jurisdiction

Defendants Lehman Brothers and Simon filed petitions for certiorari pursuant to 28 U.S.C. §1254(1) (Nos. 73-439 and 73-440 respectively) on September 6, 1973. The petition of defendants IDS, et al. (No. 73-495) was filed on September 17, 1973. This Court granted certiorari on December 3, 1973 with respect to all three petitions, limited to the following question:*

> "Did the Court of Appeals for the Second Circuit err in not certifying the question of Florida law to the Florida Supreme Court pursuant to Florida's certification procedure? Fla. Stat. Ann. Sec. 25.032 (1961), Fla. App. Rules, R. 4.61 (1967)."

Question Presented

Did the Court of Appeals for the Second Circuit commit reversible error in this action based upon diversity jurisdiction in deciding a question of Florida common law rather than certifying the question to the Florida Supreme Court pursuant to Florida's optional certification procedure where

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* This Court denied petitioners' request that it review the merits of the decision below or whether the Court below violated the principles of *Erie R. Co.* v. *Tompkins*, 304 U.S. 64 (1938) in reaching its decision.

there were no "special circumstances" warranting abstention in this case and where the petitioners did not request certification or even suggest the possibility of certification until after they had received an adverse decision on the merits?

Statement of the Case

These actions are stockholder derivative actions in which federal jurisdiction is based upon diversity of citizenship. The cases present no federal questions. They were brought on behalf of Lum's Inc. (now known as Caesar's World, Inc. but hereinafter referred to as "Lum's"), a Florida corporation, and arise out of the defendants' alleged misuse of confidential corporate information.

The *Schein* action was commenced on September 24, 1971 in the Southern District of New York. The *Gregorio* action was commenced in the Northern District of Illinois on January 12, 1971 and was transferred by consent to the Southern District of New York on April 30, 1971. (App. 9a)

The complaints herein charge that in November 1969, Melvin Chasen, Chief Executive Officer of Lum's, publicly announced that Lum's would have earnings of between $1.00 and $1.10 per share for its fiscal year ending July 31, 1970. However, on or about January 5, 1970, by virtue of his position with Lum's, Chasen learned that his earlier projection of an earnings increase for the second quarter was in error and that Lum's earnings for the year would only be about 75 cents per share. On January 8, 1970, before he disclosed this information to the shareholders of Lum's or the public generally, Chasen, in breach of his fiduciary duties to Lum's and its shareholders, called Simon, an institutional stock salesman of Lehman Brothers, and divulged to him the confidential information concerning Lum's earn-

ings. Chasen also informed Simon that the disappointing earnings were caused by problems in Lum's restaurant division, lower franchise sales and disappointing results at Caesar's Palace, a Las Vegas hotel casino owned by Lum's. On that same day after the close of trading on the New York Stock Exchange, Simon called Sit, the portfolio manager of IDS New Dimensions Fund, Inc. ("Dimensions"), and relayed the information given him by Chasen, informing Sit of the confidential source of the information. Sit immediately made the confidential information and its source known to Jundt, a manager and analyst for Investors Variable Payment Fund, Inc. ("Investors"). Both Dimensions and Investors are mutual funds for which Investors Diversified Services, Inc. ("IDS") is the investment advisor and distributor.

Based upon the nature and importance of the confidential material information which they had received from Chasen by way of Simon, IDS, Sit and Jundt determined that Dimensions and Investors should immediately sell the 83,000 shares of Lum's owned by them.

The following morning, a Friday, when trading opened on the New York Stock Exchange, Dimensions sold 40,000 shares of Lum's and Investors sold 43,000 shares of Lum's on the Exchange at approximately $17.50 per share. Each thus disposed of its entire holdings in that stock while in possession of the aforesaid confidential information and with the knowledge that such information had not been disclosed to the public generally.

At approximately 1:30 p.m. on the same day, the New York Stock Exchange halted trading in Lum's shares in anticipation of a company announcement. The announcement was made at 2:45 p.m. and contained substantially the same information that Chasen had leaked on January

8. Trading in Lum's was delayed until Monday morning, January 12, and the opening price was down over three and one-half points from the prices Dimensions and Investors received on January 9.

The complaints charge that by reason of the foregoing, the defendants participated in or aided and abetted the breach of a fiduciary duty to Lum's and that said defendants are jointly and severally liable to Lum's for all profits made by any of them as a result thereof.

Since federal jurisdiction in this case is based upon diversity of citizenship, the New York federal courts were required to decide the case as the New York State courts would have. *Erie R. Co.* v. *Tompkins*, 304 U.S. 64 (1938). Since Lum's is a Florida corporation, the federal courts, under the rule of *Klaxon* v. *Stentor Electric Mfg. Co.*, 313 U.S. 487 (1941), were required to look to New York's choice of law rules to determine which law would apply to the situation at hand. In this case Florida law governed.

The District Court (Tyler, J.), finding that there were no Florida cases which had previously dealt with the specific issues in this case, and concluding that the decision in *Diamond* v. *Oreamuno*, 24 N.Y. 2d 494, 248 N.E. 2d 910, 301 N.Y.S. 2d 78 (1969), was not applicable to the issues herein, granted defendants' motion to dismiss pursuant to FRCP 12(b)(6) for failure to state a claim upon which relief can be granted. (App. 58a)

The Court of Appeals for the Second Circuit reversed, holding that the complaints alleged a valid claim under applicable state law. In reaching its decision, the Court of Appeals clearly recognized that its function was to decide the case on the basis of Florida law. (App. 66a) In determining the law of Florida, the Court noted that:

> "• • • in the absence of a clearly enunciated state rule, the federal court may turn to the law of other jurisdic-

tions for assistance in determining how the state court would most likely decide the case if the state court were presented with the questions being litigated in the federal court." *Baxter* v. *Lancer Industries, Inc.*, 213 F. Supp. 92 (EDNY 1963), app. denied, 324 F.2d 286 (2 Cir. 1963); *Locke Manufacturing Companies* v. *United States*, 237 F. Supp. 80 (D. Conn. 1964). (App. 66a)

Since the Florida courts had never faced the precise issues which were present in this action, the Court of Appeals concluded that it was:

"* * * both proper and practical for this court to turn for guidance to the body of law of other jurisdictions and particularly to that of New York where the resolution of the issues in the *Diamond* case, decided by the New York Court of Appeals, bears on the issues in the case before us. In doing so, our objective is to interpret *Diamond* as the Florida court would probably interpret it and to apply *Diamond*, as so interpreted, to the facts presented here." (App. 66a-67a)

The Court of Appeals then discussed *Diamond*, which specifically upheld the right of a corporation to recover profits realized by corporate officials who trade on the basis of confidential corporate information, and considered whether the rationale of *Diamond*:

"* * * should extend to reach third parties who, though not officers or directors of the injured corporation, are involved with directors in a common enterprise to misuse confidential corporate information for their own enrichment." (App. 67a)

The Court of Appeals concluded:

"As a court of equity viewing the case as the Florida court would probably view it, we cannot agree that the

'stretch' of *Diamond* does not reach the defendants in this case. We find nothing in the language of *Diamond* to suggest that co-venturers of the director who breaches his duty should not be subject to the same liabilities as those of the director himself for the misuse of corporate information." (App. 68a)

In passing, the Court of Appeals observed that:

"'* * * it would be self-defeating to limit the reach of *Diamond* to directors and officers of the injured corporation who have so acted while permitting third-party co-venturers of theirs to escape liability to the corporation.

* * * To immunize such third parties from liability to the damaged corporation would encourage insider 'leaks' to outside friends and would defeat *Diamond's* purpose and effect." (App. 69a)

The Court of Appeals noted that its interpretation of *Diamond* and the application of the rationale of *Diamond* to the issues in the instant case were in accord with other authorities:

"Indeed, the general rule has always been that 'one who knowingly participates in or joins in an enterprise whereby a violation of a fiduciary obligation is effected is liable jointly and severally with the recreant fiduciary.' *Oil & Gas Ventures—First 1958 Fund Ltd.* v. *Kung*, 250 F.Supp. 744 (1966); see, *e.g.*, *Jackson* v. *Smith*, 254 U.S. 586, 589 (1921); *Sexton* v. *Sword S.S. Line Inc.*, 118 F.2d 708, 711 (2 Cir. 1941); *Bankers Life and Casualty Co.* v. *Kirtley*, 338 F.2d 1006, 1013 (8 Cir. 1964)." (App. 68a)

The Court of Appeals also noted that its conclusion that a valid claim was stated against the defendants in this case

was supported by Florida case law dealing with the duty of a fiduciary to his *cestui*:

> "Our view that all the participants in the common enterprise must assume the same risks of liability to the corporation as the offending director is supported by Florida case law dealing with the duty of a fiduciary to his cestui. The Florida courts have held that the duty of a fiduciary not to misuse the property of his cestui extends not only to the 'technical fiduciary' but also to others who are placed in a position of trust. *Quinn* v. *Phipps*, 93 Fla. 805, 113 So. 419 (1927). The confidential relationship of a fiduciary as that relationship is spelled out in Florida law extends not only to 'technical fiduciaries' but also to others who become 'fiduciaries' through the acquisition of confidential information which is 'owned' by someone else. See *Quinn* v. *Phipps*, *supra* at 420-421. When the defendants received their 'tip' from Chasen, they were automatically clothed with a duty to Lum's not to use the information for their own selfish advantages." (App. 70a)

Finally, the Court of Appeals rejected the arguments by Lehman Bros. and Simon that the complaints failed to state a valid claim against them because they had not personally profited by trading in Lum's stock and that they held no profits as constructive trustees of Lum's:

> "* * * Lehman Brothers and Simon obviously misused inside information as much as Diversified and Investors misused it, and therefore we fail to see how equity would be furthered by imposing liability only on the Funds and not on the other participants who supplied the Funds with the inside information. It is well established that the liabilities of persons engaged in a joint enterprise to commit a wrong are both joint

and several liabilities and each participant is liable to account for the profits of the other participants. *Marcus* v. *Otis*, 168 F.2d 649 (2 Cir. 1948), *modified*, 169 F.2d 148 (2 Cir. 1948); *Solomon* v. *United States*, 276 F.2d 669 (6 Cir. 1960), *cert. denied*, 364 U.S. 890 (1960), *reh. denied*, 364 U.S. 939 (1961). Accordingly, we hold that it would be proper to hold Lehman Brothers and Simon just as accountable for the profits made by their tippees Diversified and Investors as the tippees themselves.*" (App. 71a-72a)

Judge Kaufman dissented, disagreeing with the majority of the Court of Appeals in the interpretation of *Diamond* and in the application of the rationale of *Diamond* to the facts in this case. While Judge Kaufman expressed the view that the complaints did not state a valid claim against the defendants, he cited no Florida cases (or any other cases) in support of his dissenting opinion. In the last paragraph of his dissent Judge Kaufman added that the Court should have certified the issue to the Supreme Court of Florida. (App. 80a-81a)

The issues in this case were fully briefed and argued by the parties to the Court of Appeals. The petitioners did not request or even suggest in any way prior to the decision by the Court of Appeals that the question of state law in this case should not be decided by the Court of Appeals, but rather should be certified to the Supreme Court of Florida, pursuant to the optional procedures set forth in FSA §25.031 and the accompanying rules. Use of the certification procedure was suggested for the first time in Judge Kaufman's dissent.

Petitioners moved in the Court of Appeals for a rehearing. However, even in their petitions for rehearing, the

* Footnote omitted.

petitioners did not specifically request certification, but rather asked for a rehearing *en banc* on the merits. Only if the Court of Appeals was unwilling to decide in petitioners' favor, did they suggest that the issue be certified to the Florida Supreme Court.*

Summary of Argument

A federal court may abstain from deciding a question of state law in a diversity case only in narrowly limited "special circumstances". Such "special circumstances" exist only in cases (1) where a federal constitutional issue may be avoided or modified by a state court determination of state law or (2) on grounds of comity with the State, where the determination of state law involves a state regulatory scheme or other activities of state government and calls for interpretation of state regulatory statutes relating thereto; or where the state issue involves a peculiarly local matter such as the power of eminent domain or the control of natural resources within the border of the State.

The instant case, which involves the question of whether the petitioners are liable to Lum's under Florida common law for the profits made by any of them as a result of the alleged misuse of confidential corporate information, does not present any of the classic conflicts or "special circumstances" which have been held to warrant abstention. The petitioners' contention that abstention is required in any diversity case where there is an unsettled question of state law is without merit and has been repeatedly rejected by this Court.

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* Petition For Rehearing With A Suggestion For Rehearing In Banc filed by Petitioner IDS in the Court of Appeals on May 24, 1973; Suggestion For Rehearing In Banc Filed by Petitioner Lehman Brothers in the Court of Appeals on May 24, 1973.

Petitioners' argument that even if abstention was improper in this case, certification pursant to the Florida certification statute was not only proper, but was required in this case is equally unfounded. Certification is a form of abstention which is not appropriate where there are no "special circumstances" which would warrant a federal court in abstaining from a decision on a question of state law in a diversity case.

While certification may lessen somewhat the burdens which result from abstention, it clearly does not eliminate them. The certification procedure still entails substantial delay and added expense. The respondents should not be required to bear these extra burdens in this case simply because there are unsettled questions of state law involved and petitioners, having received an adverse decision on these issues in the Court below, now contend that these issues should be referred to the Florida Supreme Court so that they can have another opportunity to litigate them. It would seriously undermine diversity jurisdiction if certification were required, as petitioners urge, in every diversity case where there is an unsettled question of state law.

Assuming *arguendo* that the Court below had some discretion in determining whether to certify the issue of state law in this case, there was clearly no abuse of discretion by the Court below in not certifying the the question since there were no "special circumstances" present which warranted abstention, the parties had argued the merits of the case to the Court of Appeals and the petitioners did not even raise the possibility of using certification until *after* they had received an adverse decision on the merits.

Moreover, we submit that the petitioners waived their right to object to the fact that the question of state law in this case was not certified to the Florida Supreme Court

since, as we have noted, they did not ask the Court below to certify the question. On the contrary, they argued the merits of the case to the Court and, in effect, asked the Court of Appeals to decide the case. Under these circumstances, they should not now be heard to complain that the Court below did what they urged it to do and decided the case on the merits without certification.

ARGUMENT

The Court of Appeals Did Not Err in Not Certifying the Issue of Florida Common Law in This Case to the Florida Supreme Court Since There Were No Special Circumstances Warranting Abstention and the Petitioners Did Not Request Certification Or Even Suggest the Possibility of Certification Until After They Had Received an Adverse Decision on the Merits.

The petitioners herein contend that the Court of Appeals for the Second Circuit erred in deciding the issue of Florida common law in this case instead of certifying the question to the Florida Supreme Court as permitted by FSA §25.031 and the accompanying Court rules, notwithstanding the fact that the petitioners had argued the merits of the case to the Court of Appeals and had not requested certification. In short, petitioners, once confident of success and quite willing to have the Court below determine the applicable state law, have changed their view in the face of an adverse decision on the merits. Having raised the Florida certification procedure for the first time in their petitions for a rehearing in the Court below, they now ask this Court to reverse the decision below and give them a second chance.

A. This Was Not a Proper Case for Abstention.

The basic rule governing the obligation of federal courts to decide questions of state law in actions based upon diversity jurisdiction was set forth by this Court in *Meredith* v. *City of Winter Haven*, 320 U.S. 228 (1943), where this Court said:

> "The diversity jurisdiction was not conferred for the benefit of the federal courts or to serve their convenience. Its purpose was generally to afford to suitors an opportunity in such cases, at their option, to assert their rights in the federal rather than in the state courts. In the absence of some recognized public policy or defined principle guiding the exercise of the jurisdiction conferred, which would in exceptional cases warrant its non-exercise, it has from the first been deemed to be the duty of the federal courts, if their jurisdiction is properly invoked, to decide questions of state law whenever necessary to the rendition of a judgment. (Citations omitted.) When such exceptional circumstances are not present, denial of that opportunity by the federal courts merely because the answers to the questions of state law are difficult or uncertain or have not yet been given by the highest court of the state, would thwart the purpose of the jurisdictional act." 320 U.S. at 234-35.

This Court further observed in *Meredith* that:

> "Erie R. Co. v. Tompkins, supra, did not free the federal courts from the duty of deciding questions of state law in diversity cases. Instead it placed on them a greater responsibility for determining and applying state laws in all cases within their jurisdiction in which federal law does not govern. Accepting this responsibility, as was its duty, this Court has not hesi-

tated to decide questions of state law when necessary for the disposition of a case brought to it for decision, although the highest court of the state had not answered them, the answers were difficult, and the character of the answers which the highest state courts might ultimately give remained uncertain. (Citations omitted.) Even though our decisions could not finally settle the questions of state law involved, they did adjudicate the rights of the parties with the aid of such light as was afforded by the materials for decision at hand, and in accordance with the applicable principles for determining state law. In this case, as in those, it being within the jurisdiction conferred on the federal courts by Congress, we think the plaintiffs, petitioners here, were entitled to have such an adjudication." 320 U.S. at 237-38.

The principles set forth in *Meredith* have been reaffirmed by this Court on several occasions. Thus, in *Propper* v. *Clark*, 337 U.S. 472 (1949), this Court said:

> "We have refused in a diversity of citizenship case to allow the difficulty of an issue of state law to deter us from exercising our jurisdiction when federal determination was subject to equitable discretion and the state issue was the only one in the case. Meredith v. Winter Haven, 320 U.S. 228. To refrain from deciding it, we there said, would be to enervate diversity jurisdiction." 337 U.S. at 489-490.

Again, in *McNeese* v. *Board of Education for Community Unit School District 187*, 373 U.S. 668 (1963), this Court noted:

> "* * * Yet where Congress creates a head of federal jurisdiction which entails a responsibility to ad-

judicate the claim on the basis of state law, *viz.*, diversity of citizenship, as was true in Meredith v. Winter Haven, 320 U.S. 228, we hold that difficulties and perplexities of state law are no reason for referral of the problem to the state court:

'We are pointed to no public policy or interest which would be served by withholding from petitioners the benefit of the jurisdiction which Congress has created with the purpose that it should be availed of and exercised subject only to such limitations as traditionally justify courts in declining to exercise the jurisdiction which they possess. To remit the parties to the state courts is to delay further the disposition of the litigation which has been pending for more than two years and which is now ready for decision. It is to penalize petitioners for resorting to a jurisdiction which they were entitled to invoke, in the absence of any special circumstances which would warrant a refusal to exercise it.'" 373 U.S. at 673 n.5.

In *Meredith*, this Court indicated that only where there are "exceptional circumstances" present, may a federal court be justified in abstaining from deciding a question of state law in a diversity case. In subsequent cases, this Court reaffirmed the principle that abstention is proper only in narrowly limited "special circumstances". In *Lake Carriers Association* v. *McMullan*, 406 U.S. 498 (1972), this Court said:

"Abstention is a 'judge-made doctrine . . ., first fashioned in 1941 in Railroad Commission of Texas v. Pullman Co., 312 U.S. 496 [that] sanctions . . . escape [from immediate decision] only in narrowly limited "special circumstances," Propper v. Clark, 337 U.S. 472, 492.' Zwickler v. Koota, 389 U.S. 241, 248

(1967), justifying 'the delay and expense to which application of the abstention doctrine inevitably gives rise.' England v. Louisiana State Board Medical Examiners, 375 U.S. 411, 418 (1964)." 406 U.S. at 509.

Such "special circumstances" have been found only in cases (1) where a federal constitutional issue may be avoided or modified by a state court determination of state law, *Railroad Commission* v. *Pullman Co.*, 312 U.S. 496 (1941); *City of Chicago* v. *Fieldcrest Dairies, Inc.*, 316 U.S. 168 (1942); *Spector Motor Service, Inc.* v. *McLaughlin*, 323 U.S. 101 (1944); *Clay* v. *Sun Insurance Office, Ltd.*, 363 U.S. 207 (1960); or (2) on grounds of comity with the State, where the determination of state law involved a complex State regulatory scheme and called for a first interpretation of City or State regulatory statutes, *Burford* v. *Sun Oil Co.*, 319 U.S. 315 (1943); *Alabama Public Service Commission* v. *Southern R. Co.*, 341 U.S. 341 (1951); *City of Chicago* v. *Fieldcrest Dairies, Inc., supra*, or where the federal determination would disrupt a state administrative process, *Burford* v. *Sun Oil Co., supra*, interfere with the collection of state taxes, *Toomer* v. *Witsell*, 334 U.S. 385 (1948), or create needless friction by enjoining State officials from executing domestic policies, *Alabama Public Service Commission* v. *Southern R. Co., supra*, and finally, where the state issue involved a peculiarly local matter such as the power of eminent domain, *Louisiana Power & Light Co.* v. *City of Thibodaux*, 360 U.S. 25 (1959); *Martin* v. *Creasy*, 360 U.S. 219 (1959), the land law of a State, *Thompson* v. *Magnolia Petroleum Co.*, 309 U.S. 478 (1940) (a non-diversity case), or a determination of whether a State, where water is one of its most valuable natural resources, could, under its own Constitution, condemn private land to secure water for private business, *Kaiser Steel Corp.* v. *W. S. Ranch Co.*, 391 U.S. 593 (1968).

It is clear that neither of the two recognized situations which justify a federal court in abstaining from deciding a question of state law in diversity cases is present in the instant case. First, there is no federal constitutional question involved in this case. Second, the state law question in this case does not involve any State or City regulatory scheme or the interpretation of any statutes relating thereto; no injunctive relief has been sought which would prohibit State officials from executing State domestic policy, and finally this case does not involve a peculiarly local matter such as the power of eminent domain or the regulation of natural resources within the border of the State.

The issue in this case is simply whether petitioners, based upon the allegations of the complaint herein, are liable to Lum's under Florida common law for the profits made by any of them as a result of the alleged misuse of confidential corporate information.

In a vain effort to qualify this case as a proper abstention case, the petitioners repeatedly assert in their briefs that the determination of this question involves a determination of "fundamental public policy" of Florida and thus the federal court should have abstained from deciding the issues in this case so as to not interfere with said public policy. The petitioners, however, fail to show how the determination of the issue in this case is any more a matter of Florida public policy than the determination of other questions involving the alleged breach of fiduciary obligations to Florida corporations. Nor, indeed, do the petitioners show how this case involves Florida public policy any more than a case involving the determination of important principles of contract law covering Florida contracts or the determination of standards of due care which may be applicable to negligence actions. Indeed, it is likely that the determination of the issue of state

law in this case is of considerably less importance to Florida public policy than the determination of many other questions of corporate, contract and negligence law which will more directly control the conduct and welfare of persons in the State of Florida.

The issue in this case does not involve (as is commonly the case where abstention has been granted) whether certain conduct within a State is proper. The petitioners' conduct in this case was neither peculiarly local in nature* nor subject only to Florida law. Trading with confidential corporate information also constitutes a violation of the federal securities laws and may subject the violator to liability in an action brought by a private investor or by the Securities and Exchange Commission.**

Thus, the main issue in this case is not the propriety of petitioners' conduct, but rather whether Lum's has a remedy under Florida common law to recover the profits made by petitioners as a result of their alleged misuse of confidential corporate information. The petitioners nowhere show how it will interfere with the public policy of Florida if petitioners are held liable to Lum's for these profits.

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* The alleged improper conduct by petitioners Simon and Lehman Bros. took place in Chicago, Illinois, while petitioner IDS was located in Minnesota.

** See *SEC* v. *Texas Gulf Sulphur Co.*, 401 F. 2d 833 (2nd Cir. 1968), *SEC* v. *Texas Gulf Sulphur Co.*, 312 F. Supp. 77, 95 (S.D.N.Y. 1970), modified on appeal 446 F. 2d 1301 (2nd Cir. 1971), cert. denied 404 U.S. 1005 (1971), rehearing denied 404 U.S. 1064 (1972); *Ross* v. *Licht*, 263 F. Supp. 395 (S.D.N.Y. 1967). In an action brought by the Securities and Exchange Commission based upon the conduct involved in this case, petitioners Simon and IDS consented to the entry of judgments of permanent injunction. Lehman Bros. was found by the District Court, in said action, to have not violated the federal securities laws on the ground that they were not responsible for the actions of petitioner Simon. See *S.E.C.* v. *Lum's, Inc.*, 365 F. Supp. 1046 (S.D.N.Y. 1973).

Surely, it cannot be seriously urged that it is the public policy of Florida that persons should be permitted to engage in trading with confidential corporate information in the stock of Florida corporations and that the decision in this case will interfere with that public policy.*

Petitioners also contend that the determination of the issue in this case "will affect numerous persons with different interests in Florida corporations" (Lehman Bros. Brief, p. 36). However, again petitioners completely fail to support their contention or to show how this justifies abstention in this case. Since, as we have noted, the conduct involved in this case is already subject to the federal securities laws, the determination in this case will probably have considerably less impact on persons with interests in Florida corporations than would many other decisions involving breaches of fiduciary obligations to Florida corporations which are not subject to federal law. Furthermore, as noted above, the determination of state law in this case will probably have less effect upon persons in Florida than the determination of many important principles of contract or tort law.

The petitioners' contention that the Court below decided that "the public policy of Florida requires the encouragement of this new type of derivative lawsuit, and places a lower priority on recovery by victims of unfairness", is totally unfounded. No such determination was made by the Court of Appeals.** It simply decided that in this case,

* Even Judge Kaufman in his dissent said that "[i]n my view, it is no longer debatable that trading on inside information merits *universal condemnation*." (emphasis supplied) (App. 73a).

** The decision of the Court below clearly does not affect, nor does it purport to, the rights of individual investors to recover damages for violations of the federal securities laws, nor does it affect the right of the SEC to bring appropriate actions on their behalf.

based on the facts alleged herein, Lum's would have a right under Florida common law to recover the profits made by the petitioners.

Thus, it is apparent that this case does not present any of the classic conflicts, or "special circumstances" which have led this Court to sanction abstention. No doubt recognizing this fact, petitioners argue broadly that abstention is required in any case where there is an unsettled question of state law.* This contention, however, was specifically rejected by this Court in *Meredith*, where this Court stated that abstention is not proper "merely because the answers to the questions of state law are difficult or uncertain or have not yet been given by the highest Court of the State". 320 U.S. at 234-35. See also *McNeese* v. *Board of Education, supra.***

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* The petitioners also argue at great length in their briefs that the decision below was wrong and that the Court below did not follow the principles of *Erie R. Co.* v. *Tompkins*, 304 U.S. 64 (1938), in deciding the issues of state law in the case, notwithstanding the fact that this Court denied the petitioners' application to review these matters. Since the merits of the decision below are not before this Court, we do not believe that the petitioners' arguments on these points warrant an extended response. Suffice it to say that an examination of the decision below clearly shows that the Court of Appeals scrupulously performed its duty under *Erie* and that the Court's decision is well founded.

** Petitioners assert that notwithstanding *Meredith*, abstention was required in this case because there was a "complete absence of state decisional law", rather than merely a difficulty in legal analysis. Petitioners, however, in fact argue in their briefs that the Court below failed in its legal analysis of certain Florida decisions bearing upon the issue in question such as *Quinn* v. *Phipps*, 93 Fla. 805, 113 So. 419 (1927) and *Palma* v. *Zerbey*, 189 So. 2d 510 (Fla. App. 1966), *cert. denied* 200 So. 2d 814 (Fla. 1967), which were cited in the Court below and also in failing to properly consider certain other Florida cases, *Doeg* v. *Thornton*, 174 So. 2d 570 (Fla. App. 1965), *Renpak, Inc.* v. *Oppenheimer*, 104 So. 2d 642 (Fla. App. 1958) and *Etheredge* v. *Barrow*, 102 So. 2d 660 (Fla. App. 1958), none of which were cited by petitioners in their briefs in the court below. Thus, while petitioners suggest

Acceptance of the petitioners' argument that abstention is required in any case involving an unsettled issue of state law would as this Court said in *Meredith*, "thwart the purpose of the jurisdictional act" and would enervate diversity jurisdiction". *Propper* v. *Clark, supra* at 489-490.

B. Since Abstention Was Not Warranted in This Case, Certification Would Not Have Been Appropriate.

Defendants argue that even if abstention would be improper, nevertheless certification of the question pursuant to the Florida certification statute would be proper and that failure to certify the question in this case constituted error by the Court below.

Certification, however, is a form of abstention. By certifying the question, the federal court abdicates its responsibility to decide the issue of state law in a diversity case as required by this Court in *Meredith*. Thus, while certification may be preferable to outright dismissal of the federal action as a form of abstention, the question remains whether it is proper for the federal court to abstain at all from deciding the issue of state law and to submit the question to the state court for decision. Since certification is a form of abstention, it should not be sanctioned in the absence of "special circumstances" which would warrant the federal court abstaining from deciding the question of state law in a diversity case. In *Propper* v. *Clark, supra*, this Court indicated that a federal court should not submit questions of state law to a

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that there was a complete absence of state decisional law bearing upon the issue in question, they in fact argue that the court below failed in its legal analysis of certain relevant Florida decisions. In any event, the obligation of the federal court to determine issues of state law in a diversity case, as set forth in *Meredith*, should not depend upon so ephemeral a distinction.

state court where federal courts have been granted jurisdiction of the controversy in the absence of "special circumstances" which would justify abstention. Thus, this Court said:

> "Erie R. Co. v. Tompkins, 304 U.S. 64, a common-law case, is itself a precedent against any general ruling that cases properly in the federal courts that depend upon state law should have that issue submitted to state courts for decision.
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> • • •
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> The submission of special issues is a useful device in judicial administration in such circumstances as existed in the Magnolia, Spector, Fieldcrest and Pullman cases, supra, but in the absence of special circumstances, 320 U.S. at page 236, 237, it is not to be used to impede the normal course of action where federal courts have been granted jurisdiction of the controversy.
>
> We reject the suggestion that a decision in this case in the federal courts should be delayed until the courts of New York have settled the issue of state law." 337 U.S. at 490-91.

Petitioners' reliance upon *Clay* v. *Sun Insurance Office, Ltd., supra,* in support of their contention that certification is proper even in the absence of "special circumstances" which would justify abstention is clearly misplaced. *Clay* reached this Court because the Court of Appeals for the Fifth Circuit had unnecessarily decided a federal constitutional question in a case which might have otherwise turned entirely on an issue of state law. In vacating the decision, this Court remanded the case to the Court of Appeals for a determination of the rele-

vant state law with the suggestion that the Court use the Florida certification procedure.* Thus, *Clay* involved a classic example of abstention where a determination of state law might avoid or modify a constitutional question.**

Petitioners' reliance on *Dresner* v. *City of Tallahassee*, 375 U.S. 136 (1963) and *Aldrich* v. *Aldrich*, 375 U.S. 75 (1963) in support of their contention that certification is proper in any diversity case where there is an unsettled question of state law is also misplaced. Neither of these cases were diversity actions. *Dresner* was a Florida state court case in which this Court in an exercise of discretion certified doubtful questions of state law to the Florida Supreme Court since the resolution of these state law questions might obviate the need for this Court to determine the constitutional issues involved. *Aldrich* arose in the West Virginia State Courts and was concerned with the effect to be given to a Florida judgment under the full faith and credit clause. These cases obviously lend no support to the suggestion that lower federal courts sitting in diversity jurisdiction are *obligated* to certify unsettled questions of state law to the Florida Supreme Court when

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* In strongly suggesting, but not explicitly mandating use of the Florida certification procedure, this Court took particular note of the fact that the Court of Appeals for the Fifth Circuit had admitted that "it could not on the available materials make a confident guess how the Florida Supreme Court would construe the statute". 363 U.S. at 212. The case at bar sharply contrasts with *Clay*. First, there is no federal constitutional question involved and therefore no possibility of an unnecessary constitutional adjudication. Second, the Court of Appeals in the instant case did not express an inability to determine the state law question at issue and in fact determined it in a carefully reasoned opinion.

** In *Zwickler* v. *Koota*, 389 U.S. 241 (1967), this Court referred to *Clay* as an example of a diversity case in which "special circumstances" were found which warranted abstention. 389 U.S. at 249 n.11.

no "special circumstances" are present and where none of the parties request such certification.

The cases in which the Court of Appeals for the Fifth Circuit has utilized the Florida certification procedure are equally unavailing to support petitioners' contention that certification is proper in the absence of "special circumstances". The Fifth Circuit cases which have utilized this procedure have typically involved a consented stipulation framing the question to be certified, see e.g. *A. R. Moyer, Inc.* v. *Graham*, 443 F. 2d 434 (5th Cir. 1971) and in only one of the Fifth Circuit cases cited by the petitioners does it appear that any opposition was raised to certification.*

Petitioners also argue that certification may be used in any diversity case where there are unsettled issues of state law because Florida by enacting a certification statute has evidenced a public policy to have such issues decided by the Florida Supreme Court rather than by a federal court in a diversity action. In passing, it should be noted that the Florida certification statute merely provides that the federal court "may" certify such questions to the Florida Supreme Court and, of course, does not purport to require the federal court to do so. The simple answer, however, to petitioners' argument is that the State of Florida cannot by enacting a certification statute, take away the rights

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* In *National Education Association* v. *Lee County Bd. of Public Instruction*, 448 F. 2d 451 (5th Cir., 1971) one of the parties raised some objection to certification. However, as indicated by the Court, he did not press his objection. The Fifth Circuit cases cited by the petitioners certainly do not support the contention herein asserted, that certification is proper in the absence of both "special circumstances" and the consent of the parties. Moreover, as we shall show, the Fifth Circuit regards the use of the Florida certification procedure as purely discretionary. Thus, these cases lend no support to petitioners' contention that the Court below, in not certifying the question in this case where there were no "special circumstances" and where none of the parties requested certification, committed reversible error.

granted to litigants under federal law to have their claims decided in federal court in diversity cases. The question of whether abstention by certification is proper in a diversity case is governed by federal law and by the principles set forth by this Court in *Meredith* and in other cases involving the abstention doctrine.

In his well-known treatise on the federal courts, Professor Wright specifically cautions against permitting the kind of expansive use of certification urged by the petitioners herein:

> "The availability of a certification procedure may tempt a federal court to abstain by certification where there is no justification for abstention, except that the state question is difficult.
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> • • • • •
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> • • • certification is an undesirable innovation if it will lead to abrogation of the *Meredith* doctrine. If a federal court must defer to the state court whenever a state issue in a case is difficult, the federal judiciary will no longer be able to function as a court. Such an extension of abstention would justify the reference by Judge Charles E. Clark to 'that wilful, perhaps even illegitimate, child of the Erie-Tompkins Rule, namely the 'abstention doctrine'". Wright, *Federal Courts*, § 52 (1963 ed.)

Similar expressions concerning the use of certification are found in other commentaries which have addressed themselves to this question.

> "However it must be remembered that this procedure can be used only in those cases which require the operation of abstention and *not in all cases involving issues*

of uncertain state law." (Emphasis supplied by the author) Note, 16 Miami L. Rev. 413, 433 (1962).

In Gowan & Izlar, *Federal Court Abstention in Diversity of Citizenship Litigation*, 43 Tex. L. Rev. 194 (1964), which is cited by petitioners, the author states, at p. 209:

> "If the underlying rationale of *Meredith* is that federal courts may not abnegate their jurisdiction to decide, in a diversity case, issues involving difficult questions of state law, it seems clear that they cannot abstain by invoking the certification procedure and then hold that they are bound under the theory of the law of the case. The parties are entitled to have state issues litigated in a federal court and decided by federal court; this in effect is the essence of diversity—of—citizenship jurisdiction".

In Mattis, *Certification of Questions of State Law: An Impractical Tool in the Hands of the Federal Courts*, 23 U. Miami L. Rev. 717 (1969), the author also warns of the danger of an improper use of certification by the federal courts:

> "The availability of a certification procedure has resulted in the federal courts forgetting the teaching of *Meredith* v. *City of Winter Haven*, and using the procedure merely to solve difficult questions of state law.
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> * * * * *
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> * * * That restriction of the use of certification to exceptional situations is desirable is borne out by the fact that the recent use of certification has exacted too high a price for theoretically correct answers to *Erie*-posed problems". 23 U. Miami L. Rev. at 729-30, 735.

While certification may lessen somewhat the burdens which result from abstention, it hardly eliminates them. There will still be substantial delay and additional expense as a result of certification. This delay has been more than one year in most of the cases where the procedure has been used in Florida. Mattis, *supra,* 23 U. Miami L.Rev. at 726.*

The delay involved in certification is even more pronounced where, as in the instant case, the petitioners did not even suggest the possibility of certification until *after* the Court below had rendered an adverse decision on the merits. Even then, petitioners did not specifically request certification, but rather asked for a rehearing *en banc* on the merits. Only if the Court below was unwilling to decide in petitioners' favor did the petitioners suggest that the question be certified.**

The certification procedure not only results in substantial delay, but also makes the litigation substantially more expensive. We submit that the respondents should not be required to bear these extra burdens simply because there are unsettled issues of state law in this case*** and the

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* The Florida certification procedure involves a full-dress appeal. In addition, before certification can take place, the certified question must be formulated, which frequently involves additional delay. Thus, where certification is used:

> "In effect, two appeals are created where only one existed before. This concept of two for one might be desirable in growing stalks of wheat, but its value is negative in the field of legal appeals." Mattis, *supra,* 23 U. Miami L. Rev. at 728.

** In the instant case, the Court of Appeals finally issued its mandate, after denying petitioners' applications for rehearing, approximately 17 months after notice of appeal was filed. (App. 8a).

*** If the Court below were now required to certify the issues raised by petitioners' motions to dismiss the complaints herein, it might also be required to subsequently certify the question of whether the plaintiffs proved a violation of Florida common law (since the proof adduced at trial might vary from the allegations of the complaints). Thus, if certification is required in this case.

petitioners, having received an adverse decision on these issues in the Court below, now contend that these issues should be referred to the Florida Supreme Court so that they can have another opportunity to litigate them.

In *Clay* v. *Sun Insurance Office Ltd., supra,* (dissenting opinion), Mr. Justice Douglas made the following cogent remarks:

> "• • • I desire to give renewed protest to our practice of making litigants travel a long, expensive road in order to obtain justice.
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> • • • • •
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> "Some litigants have long purses. Many, however, can hardly afford one lawsuit, let alone two. Shuttling the parties between state and federal tribunals is a sure way of defeating the ends of justice. The pursuit of justice is not an academic exercise. There are no foundations to finance the resolution of nice state law questions involved in federal court litigation. The parties are entitled—absent unique and rare situations—to adjudication of their rights in the tribunals which Congress has empowered to act."

The petitioners seem to suggest that this Court should disregard the fact that there would be substantial delay and added expense if certification were required in this case because this is a stockholder's derivative action. Yet, this Court and other courts have recognized that stockholder's derivative actions serve a useful purpose and should be encouraged. *Surowitz* v. *Hilton Hotels Corp.*, 383 U.S. 363, 371 (1966); *Mills* v. *Electric Autolite Co.*, 396 U.S. 375, 396 (1970); *Denney* v. *Phillips & Buttorf Corp.*, 331

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the time and expense involved in litigating these actions, which have already been pending for approximately 3 years, may be inordinately increased.

F.2d 249, 251 (6th Cir. 1964). Such actions would hardly be encouraged if they were made more expensive and time consuming to prosecute.

Petitioners have cited a few decisions, e.g. *Essex Universal Corp.* v. *Yates,* 305 F.2d 572 (2nd Cir., 1962), in which the court has noted the problems involved in discharging its duty under *Erie* to decide questions of state law. The fact that this problem is sometimes difficult hardly means, however, that federal courts should be free to avoid their responsibilities under diversity jurisdiction to decide such questions in the absence of "special circumstances" which would warrant abstention and reference of said question to the state court for determination. See *Meredith* v. *City of Winter Haven, supra; McNeese* v. *Board of Education, supra;* and *Propper* v. *Clark, supra.*

In support of their argument that certification should be broadly permitted, petitioners also cite a few cases, e.g. *Kaiser Steel Corp.* v. *W. S. Ranch Co., supra,* where the state court came to a different conclusion on a question of state law after the federal court had determined the issue. While this may occasionally happen, it hardly justifies adopting a rule which would clearly undermine the principles of diversity jurisdiction and would make the prosecution of diversity cases much more expensive and time consuming.*

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* It should be noted that there are also occasions where the state court benefits in subsequent cases from a carefully reasoned opinion by the federal court on an issue of state law. See Note, *Abstention and Certification in Diversity Suits: "Perfection of Means and Confusion of Goals"*, 73 Yale L.J. 850, 864 (1964); Liebenthal, *A Dialogue on England,* 18 W. Res. L. Rev. 157, 194 (1966). Moreover, the problem of a possible disparity between federal and state court decisions is no different than the problem which may result whenever a foreign forum interprets a state's law under conflict-of-law rules. See Note, 69 Yale L. J. 643, 660 (1960). Indeed if plaintiffs had brought the instant cases in the state court of New York, that court would have had to determine what Florida law was and to apply that law to this case.

Petitioner Simon argues that certification is necessary to prevent forum shopping. In support of his contention, he suggests that the plaintiffs brought their actions in New York's federal court to get the benefits of the decision of the New York Court of Appeals in *Diamond* v. *Oreamuno*, 24 N.Y. 2d 494, 248 N.E. 2d 910, 301 N.Y.S. 2d 78 (1969). Yet, in fact, the *Gregorio* case was instituted in the Northern District of Illinois and was transferred to the Southern District of New York with the consent of the defendants and the *Schein* case was brought in the *Southern* District of New York because plaintiff Schein's counsel were located there and jurisdiction could be obtained there over most of the parties. Furthermore, if the plaintiffs were concerned about getting the benefit of the *Diamond* case, they could have brought this action in the New York state court from which certification is not available. Petitioners' statement that the decision by the Court below in this case will result in a flood of diversity cases in the Second Circuit involving trading with confidential corporate information in the stock of Florida corporations is without foundation. What is much more significant than the "problem" of forum shopping which the petitioner refers to (which is largely eliminated by the application of the principles of *Erie R. Co.* v. *Tompkins, supra*) is the danger of "eleventh-hour forum shopping" which occurs when parties, like the petitioners herein, have lost in the federal court and then seek to gain access to the state court to relitigate the issues. See Mattis, *supra*, 23 Miami L. Rev. at 732.

Finally, petitioners contend that this Court should broadly permit certification because diversity jurisdiction detracts from the time and resources of the federal courts to deal with more important matters. Thus, petitioners reveal the paucity of their arguments by urging this Court to, in effect, base its determination in this case on consid-

erations which are the business of Congress rather than this Court. See *Louisiana Power & Light Co.* v. *City of Thibodaux, supra* (dissenting opinion) where Mr. Justice Brennan, in discussing diversity jurisdiction, noted:

> "The roots of that jurisdiction are inextricably intertwined with the roots of our federal system. They stem from Art. III Section 2 of the Constitution and the First Judiciary Act, the Act of 1789 1 Stat. 73, 78.
>
> • • • • •
>
> Until Congress speaks otherwise, the federal judiciary has no choice but conscientiously to render justice for litigants from different states entitled to have their controversies adjudicated in the federal courts. 'Whether it is a sound theory, whether diversity jurisdiction is necessary or desirable in order to avoid possible unfairness by state courts, state judges and juries, against outsiders, whether the federal courts ought to be relieved of the burden of diversity jurisdiction,—these are matters which are not my concern as a judge. They are the concern of those whose business it is to legislate, not mine'. *Burford* v. *Sun Oil Co.*, 319 U. S. 315, 337 (dissenting opinion)." 360 U.S. at 41-42.*

This Court has made it clear that there is a very narrow corridor through which a federal court may "escape" from its obligation to decide state law questions when federal jurisdiction is properly invoked. To accept the petitioners' contention that certification is appropriate in any case where there is an unsettled issue of state law would be to turn this narrow corridor into a wide canyon.

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* Footnotes omitted.

C. Assuming *Arguendo* That the Court of Appeals Had Some Discretion to Certify the Question of State Law in This Case, There Was No Abuse of Discretion by the Court of Appeals in Not Certifying the Question.

Assuming *arguendo* that the Court below had discretion in this case to determine whether to certify the issue of state law to the Florida Supreme Court, we submit that there was clearly no abuse of discretion by the Court below in deciding the merits of the case and not certifying the issue to the Florida Supreme Court. First of all, as we have shown, there were no "special circumstances" in this case which would warrant the federal court abstaining from a decision on the state law question involved in this case.

Furthermore, the failure of the petitioners to request certification or even to suggest the possibility of certification to the Court below until *after* the Court below had rendered a decision adverse to them obviously weighs heavily against any claim by the petitioners that the Court below abused its discretion in not certifying the question of state law in this case to the Florida Supreme Court.*

In *Hostetter* v. *Idlewild Bon Voyage Liquor Corp.*, 377 U.S. 324 (1964), this Court, in holding that the District Court did not err in determining not to abstain from a decision on the merits in the case, noted that "neither party requested it". 377 U.S. at 329.

In support of their new found view that the Court below should have certified the question to the Florida Supreme Court, petitioners rely upon several cases in which

* Indeed, we submit that whatever "rights" petitioners may have had to have the issues of Florida law in this case certified to the Florida Supreme Court instead of having them decided by the Court of Appeals for the Second Circuit were waived by petitioners when they argued the merits of the case to the Court below and never even raised the question of certification. See Point D, *infra*.

the Court of Appeals for the Fifth Circuit followed that option. The fact, however, that the Fifth Circuit sometimes uses the Florida certification procedure* hardly demonstrates that the Court of Appeals for the Second Circuit abused its discretion in not certifying the question in this case, where there were no "special circumstances" present and none of the parties requested certification.

Petitioners contend that certification of unsettled questions of state law is necessary in the interests of fairness to the litigants. Yet it is difficult to understand how petitioners can seriously claim that the failure of the Court below to certify the questions of state law in this case was unfair to them when they never asked the Court below to certify the question or to do anything other than decide the issue on the merits.

It should be emphasized that the issue before this Court is not, as petitioners would have it, whether this Court agrees with the general proposition that the Florida certification procedure may be a useful device in those cases where abstention is appropriate, but rather whether the

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* It should be noted that the Florida certification procedure has been regarded by the Fifth Circuit as a purely discretionary procedure. *Trail Builders Supply Co.* v. *Reagan*, 409 F. 2d 1059, 1061 (5th Cir. 1969). While the Fifth Circuit has often chosen to use this optional procedure, it has also on several occasions decided not to use it and to determine unsettled issues of Florida law itself. See e.g. *Weitzner* v. *United States*, 309 F. 2d 45 (5th Cir. 1962) (Court construes homestead provisions of Florida's constitution); *Hamilton* v. *Maryland Casualty Co.*, 368 F. 2d 768 (5th Cir. 1966) (Purely local dispute as to the meaning of an insurance contract; the court declined to certify the question even though it admitted that the state court might have been better able to resolve the issue; in deciding the issue, the court looked to the case law of 12 states); see also *Motor Vehicle Casualty Co.* v. *Atlantic National Insurance Co.*, 374 F. 2d 601 (5th Cir. 1967); *Greer* v. *Associated Indemnity Corp.*, 371 F. 2d 28 (5th Cir. 1967); *Pacific Indemnity Co.* v. *Broward Co.*, 465 F. 2d 99 (5th Cir. 1972); *Habecker* v. *Young*, 474 F. 2d 1229 (5th Cir. 1973).

Court below erred by deciding the merits of this case and not using the certification procedure where the parties argued the merits of the case to the Court and the petitioners never even suggested the possibility of using certification until after they received an adverse decision on the merits.

We submit that assuming *arguendo* the Court below had any discretion to certify the question of state law in this case to the Florida Supreme Court, there was clearly no abuse of discretion by the Court below in not certifying the question and in deciding the case on the merits.*

D. The Petitioners Waived Their Right to Object to the Fact That the Question of State Law in This Case Was Not Certified to the Florida Supreme Court Since They Argued the Merits of the Case to the Court of Appeals and Did Not Request or Even Suggest the Possibility of Certification Until *After* the Court of Appeals Had Rendered an Adverse Decision on the Merits.

We submit that whatever "rights" petitioners may have had to have the issues of Florida law in this case certified to the Supreme Court of Florida instead of having them decided by the Court of Appeals for the Second Circuit surely must have been waived by petitioners when they argued the merits of the case to the Court below and never even raised the question of certification. See *Yakus* v. *United States*, 321 U.S. 414, 444 (1944).

In *England* v. *Louisiana State Board of Medical Examiners*, 375 U.S. 411 (1964), this Court (in a reverse situation) indicated that where a party, like the petitioners herein, freely litigates his claims in one court even though

* Since Judge Kaufman referred briefly in his dissenting opinion to the possibility of certification, it is reasonable to assume that the Court below considered the matter and determined that certification would not be appropriate in this case.

he may not be required to do so, he should not be allowed to ignore an adverse decision and start all over in another court. This Court said, at pp. 419-20:

> "But we see no reason why a party after unreservedly litigating his federal claims in the state courts although not required to do so, should be allowed to ignore the adverse state decision and start all over again in the District Court. Such a rule would * * * countenance an unnecessary increase in the length and cost of the litigation; * * *. We now explicitly hold that if a party freely and without reservation submits his federal claims for decision by the state courts, litigates them there, and has them decided there, then— * * * he has elected to forego his right to return to the district court."

In the instant case, the petitioners did not ask the Court below to certify the question. On the contrary, they argued the merits of the case to the Court and in effect asked the Court below to decide the case. Under these circumstances, they should not now complain that the Court below did what they, in effect, asked it to do. *Milliken* v. *Meyer*, 311 U.S. 457, 461 n.8 (1941); *Mercer* v. *Theriot*, 377 U.S. 152, 154 (1964); *F. W. Woolworth* v. *Contemporary Arts, Inc.*, 344 U.S. 228, 231 (1952); *Hampson* v. *Bucyrus-Erie Co.*, 474 F.2d 562 (3rd Cir. 1972); *Glassman Construction Company* v. *United States*, 421 F. 2d 212 (4th Cir. 1970); *National Utility Service, Inc.* v. *Whirlpool Corp.*, 325 F. 2d 779, 780 n.3 (2nd Cir. 1963); *Orenstein* v. *United States*, 191 F. 2d 184, 193 (1st Cir. 1951) 5 C.J.S. Appeal & Error §1501. In *Glassman, supra*, the Court said, at p. 215:

> "We think Glassman is precluded from complaining of errors invited by it on the previous appeal.* See 5 C.J.S. Appeal & Error §1513 (1958).

* Footnote omitted.

Glassman strongly urged our duty to decide the issues of estoppel and payment on the prior appeal. It should not be heard now to complain that we did what it asked of us."

See also Note, 12 William and Mary L. Rev. 627 (1971) where the author states at p. 640:

"• • • The federal court might deem waived the right of the litigants to certify a question in the absence of a motion for certification *before* the court rules on the matter of state law." (emphasis supplied).

Finally, where a litigant objects to having an issue decided by a particular Judge or Court, he cannot wait until after an adverse decision has been rendered before raising his objection. *Laughlin* v. *United States,* 151 F. 2d 281 (D.C. Cir. 1945), cert. denied 326 U.S. 777 (1945); *In Re United Shoe Machinery Corp.,* 276 F. 2d 77 (1st Cir. 1960); *Pacheco* v. *People,* 300 F. 2d 759 (1st Cir. 1962); *Arnold* v. *McGuinness,* 289 F. Supp. 210 (N.D. Cal. 1968), aff'd. 400 F. 2d 392 (9th Cir. 1968), cert. denied 394 U.S. 918 (1969). As the Court of Appeals for the First Circuit stated in *United Shoe, supra* at 79, in an analogous situation involving a motion for disqualification of a judge:

"One of the reasons for requiring promptness in filing is that a party, knowing of a ground for requesting disqualification can not be permitted to wait and decide whether he likes subsequent treatment that he receives. As was said in State ex rel. Shufeldt v. Armijo, 1935, 39 N.M. 502, at page 506, 50 P.2d 852, at page 855,

"A litigant cannot experiment with the judge presiding over the case • • •.

> "* * * We cannot permit a litigant to test the mind of the trial judge like a boy testing the temperature of the water in the pool with his toe, and if found to his liking, decides to take a plunge."

We submit that the petitioners' claim that the Court below erred in not certifying the issues of Florida law in this case even though there were no "special circumstances" present, coming as it does only after petitioners "tested the water" and found it not to their liking, clearly should be rejected.

CONCLUSION

The Judgment of the Court of Appeals for the Second Circuit Should Be Affirmed.

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SUPREME COURT U S
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IN THE

Supreme Court of the United States

OCTOBER TERM 1973

No. 73-495

INVESTORS DIVERSIFIED SERVICES, INC., INVESTORS VARIABLE PAYMENT FUND, INC. and IDS NEW DIMENSIONS FUND, INC.,
Petitioners,

v.

JACOB SCHEIN and MARVIN H. SCHEIN,
Respondents.

INVESTORS DIVERSIFIED SERVICES, INC.,
Petitioner,

v.

ANTONE F. GREGORIO,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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IN THE

Supreme Court of the United States

OCTOBER TERM 1973

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Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR PETITIONERS

This brief is submitted on behalf of petitioners Investors Diversified Services, Inc., Investors Variable Payment Fund, Inc., and IDS New Dimensions Fund, Inc., in reply to the brief for respondents dated February 19, 1974 (hereafter cited as "R.Br.").

Contentions that Abstention and Certification are Identical

The respondents urge (R.Br. 13-31) that this would not be a proper case for abstention, and that therefore it is not an appropriate one for certification. They rely heavily on language in *Meredith* v. *City of Winter Haven,* 320 U.S. 228, 234-35, 237-38 (1943), indicating that under *Erie R.R. Co.* v. *Tompkins,* 304 U.S. 64 (1938), federal courts have an obligation to decide questions of state law in diversity cases, which can be avoided by abstention only where there are "exceptional circumstances."

What respondents fail to perceive is that classical abstention, as exemplified by *Meredith,* mandates the dismissal of the federal complaint and remits the parties to the State court. Under certification, the federal case remains pending while an authoritative answer to a State law question is obtained from the highest State court. Thus, it is clear that abstention is a much more drastic remedy than certification, which may entail only a short period of delay.*

This Court has previously recognized such a distinction between types of abstention even in situations not involving certification. In *Louisiana Power & Light Co.* v. *City of Thibodaux,* 360 U.S. 25 (1959), the action of a district court in staying a federal case pending an interpretation of a state law was upheld, while on the same day in *County of Alleghany* v. *Frank Mashuda Co.,* 360 U.S. 185 (1959), the Court disapproved an abstention by dismissal of a federal court complaint.

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* For example, a six-month period is noted in *Martinez* v. *Rodriguez,* 410 F.2d 729 (5th Cir. 1969), at 731, fn. 7. This short delay may be compared with the seventeen months which elapsed between Judge Tyler's opinion and the Second Circuit reversal.

Abstention in this case would be justified in the absence of a certification statute, we submit, but that is not the issue. The position of respondents that the same "exceptional circumstances" or "special circumstances" that might be necessary to support abstention must be present in order to justify certification (R.Br. 21, *et seq.*) in effect would render nugatory the action of Florida and other states in adopting certification procedures. The only criterion under the Florida statute is that the case involve determinative issues as to which "there are no clear controlling precedents in the decisions of the supreme court of this state" (Florida Annotated Statutes, § 25.031). While we believe that a policy question of Florida law is involved here, it is not a requisite of certification that this be the case.

The respondents rely on *Propper* v. *Clark,* 337 U.S. 472 (1949), as indicating that a federal court should not submit questions of state law to a state court in the absence of circumstances which would justify abstention (R.Br. 21-22). In that case, however, there was no clear and expeditious state procedure for obtaining a state determination by certification such as the Florida statutes and rules provide.

The respondents have made an attempt (R.Br. 16-17) to categorize the "special circumstances" in which abstention has been held justified. This is a fruitless exercise, however, since this case involves certification rather than abstention.

Respondents set up a straw man by complaining (R.Br. 24-25) that Florida has, by its certification statute, sought to take away their right to have their claims decided in federal court. This is not the thrust of the Florida statute. Under *Erie* v. *Tompkins,* federal claims based solely on state law, as in this case, must be determined in accordance with that law. There is no doubt that the federal courts in

diversity cases are required to follow the decisions, where they exist, of the appropriate state courts. Obviously, the ultimate arbiters of a correct determination of state law are state courts, and the purpose of the Florida and other certification statutes is to provide a means of obtaining correct determinations, without ousting the federal courts of jurisdiction.

The Matter of "Abuse of Discretion"

The respondents urge that "assuming arguendo" that the court of appeals had discretion to certify the question of law, there was no abuse of discretion in not doing so (R.Br. 32-34). The apparent negative implication of this argument, that the court of appeals had no power or right to certify, is clearly without merit, and even respondents do not clearly suggest otherwise. The applicable Florida rule permits certification by the court of appeals "upon its own motion" or upon an approved "suggestion or motion of any interested party" (Florida Appellate Rule 4.61 c). This Court itself has ordered certification on its own motion. *Clay* v. *Sun Insurance Office, Ltd.*, 363 U.S. 207 (1960); *Aldrich* v. *Aldrich*, 375 U.S. 75 (1963); *Dresner* v. *City of Tallahassee*, 375 U.S. 136 (1963). It is the position of these petitioners that in the circumstances of this case there was no discretion to fail to certify, or that, under these circumstances there was an abuse of discretion in such failure.

The primary basis of respondents' contention that there was no abuse of discretion is that petitioners did not request certification until after a decision adverse to them on the merits.* This is a reiterated theme of respondents (R.Br. pp. 9-10, 31-34, 35-36). It is of course true that petitioners did not seek certification until after a two-man

*Respondents' only other asserted basis is a repetition of the specious claim that certification requires the same "special circumstances" as abstention.

majority of the court of appeals had reversed the dismissal of the complaint in the district court by Judge Tyler. The practical explanation is obvious; the petitioners, defendants below, had prevailed, and had no reason to believe that the court of appeals would disregard the lack of Florida precedent and create a novel "Florida" cause of action. As noted above, this Court has ordered certification without a suggestion from any party, and here Judge Kaufman urged it in dissent. Certification was also specifically urged in the petition for rehearing filed by these petitioners.

As respondents indicate (R.Br. 34, note), Judge Kaufman's reference to the two-judge majority as having refused to utilize certification makes it clear that the matter probably was discussed. The suggestion that this supports a view that there was no abuse of discretion, however, is unwarranted. The situation here, actually, is one of an equal division among the federal judges who considered the matter on the merits in guessing what conclusion the Florida courts would reach concerning Florida law, with Judges Tyler and Kaufman reaching one conclusion, and Judges Waterman and Smith another. All agreed, however, that the cause of action asserted here is wholly unprecedented in Florida law and that there are no "clear controlling precedents" of the Florida Supreme Court.* Under these circumstances, we submit, it was at best an abuse of discretion not to obtain a definitive answer from the Florida Supreme Court.

The Question of Waiver

The final argument of respondents is similar if not identical to the one relating to abuse of discretion, and is that the petitioners waived their right to object to the failure to certify the question by arguing the merits and not re-

*Judges Waterman and Smith cited only one Florida case, *Quinn* v. *Phipps*, 93 Fla. 805, 113 So. 419 (1927), which dealt with a real estate broker's breach of duty to his principal, and in no way foreshadowed the claim urged here.

questing certification (R.Br. 34-37). In support of this, respondents quote (R.Br. 35) a passage from *England* v. *Louisiana State Board of Medical Examiners*, 375 U.S. 411 (1964), to the effect that a party who submits federal claims to a state court and loses cannot then start over in a federal court.

The *England* case, which respondents characterize as "a reverse situation," in fact provides a strong argument for certification. The case involved questions of both state law and federal law and was begun in a federal court, which abstained pending the outcome of a state court declaratory judgment action. In the state court the plaintiff argued both the state law issue and the federal issue, and both were decided adversely to plaintiff. Thereafter, when an effort was made to relitigate the federal question in the still-pending federal action, the district court dismissed the case. The opinion cited by respondents was on appeal from this dismissal. This Court, in the passage cited by respondents, announced that in the future litigants who submitted both federal and state claims to a state court would be deemed to have waived the right to have the former decided in federal court. In the *England* case itself, however, the Court did not hold there was a waiver, because the plaintiff had proceeded on the erroneous impression derived from a previous decision that both claims must be submitted to the state courts.

In a concurring opinion in *England*, Justice Douglas suggested that perhaps there should be a reconsideration of the entire abstention doctrine, which he said had resulted in great expense and delay for litigants. He noted the advantages of the certification procedure over abstention, and as indicated in our main brief (pp. 16-17), said that the use of certification should be encouraged (375 U.S. at 433-34). As we have said, this is an ideal case for such encouragement.

In the instant case, there is no question of federal law, although the majority in the court of appeals relied substantially on federal securities law cases (93a) and the policies underlying them, in guessing at Florida law by extending a New York state case beyond its holding, which was itself an unprecedented extension of state law. Federal court litigants in such a case as this one, where federal jurisdiction is based solely on diversity, are entitled (1) to have the state law question correctly determined in accordance with Florida law, and (2) to have fact questions determined in the federal court. Cf. the *England* case, *supra*, 375 U.S. at 415-17. The first right may be effectively protected by the procedure of certification. The fact that the certified question here would be based solely on the allegations of the complaint limits the function of the Florida Supreme Court in a way that protects the second right and eliminates the confusion and delay incident to situations like that in the *England* case.

CONCLUSION

For all the reasons stated in the main brief for these petitioners and in this brief, the decision of the Second Circuit majority should be reversed.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-439

LEHMAN BROTHERS,

Petitioner,

v.

JACOB SCHEIN; MARVIN H. SCHEIN; ANTONE F. GREGORIO; LUM'S INC.; MELVIN CHASEN; BENJAMIN SIMON; INVESTORS DIVERSIFIED SERVICES, INC.; INVESTORS VARIABLE PAYMENT FUND, INC.; IDS NEW DIMENSIONS FUND, INC.; EUGENE S. SIT; AND JAMES R. JUNDT,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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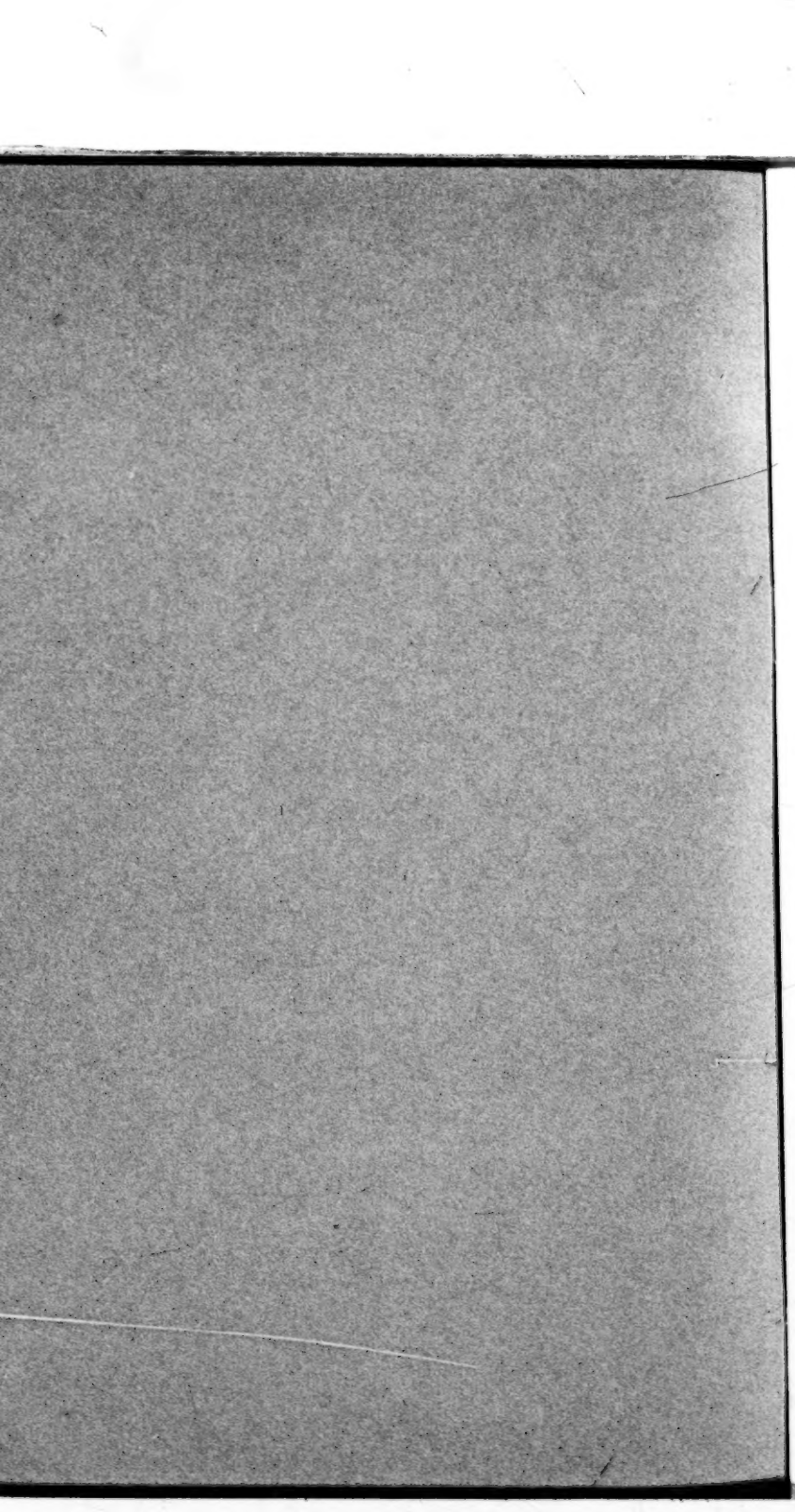

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Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR PETITIONER LEHMAN BROTHERS

Petitioner Lehman Brothers respectfully submits this brief in reply to contentions made in the brief of respondents Schein and Gregorio.

POINT I

Availability of certification renders unsupportable the refusal of the court below to permit Florida to declare its own public policy.

A. Respondents have failed to address themselves to the issue before this Court.

Respondents recognize, as they must, that this Court has directed the referral of questions of state law to state courts in a variety of circumstances (R. Br. 16-17), but they refuse

to examine the decision below in the light of such precedents to determine whether similar action was necessary here. Instead, they rely on the argument that the court below "did not express an inability to determine the state law question at issue and in fact determined it" (R. Br. 23n.), assert without support that the court below "scrupulously performed its duty under *Erie*" (R. Br. 20n.), and repeatedly tell this Court that the Second Circuit decision "simply" concerns "a remedy under Florida common law" (R. Br. 10, 17, 18, 20). The central issue, they claim, does not call for a determination of Florida public policy and presents no such special need for a correct result as would call for abstention. Certification of such an issue, respondents claim, would "undermine the principles of diversity jurisdiction" (R. Br. 29).

To explain their total refusal to discuss the implications of the ruling below, respondents argue that this Court addressed the grant of the writ only to the question of the necessity for certification. But the specific question posed by the Court only reflects the practical limits of its concern, in general, with the merits of state law issues on which this Court lacks final authority. Such limits make plain the need for correct decisions of important state law issues in the lower federal courts. For such decisions are in practice not reviewable, and if they are not faithful to the state law, the principles of diversity jurisdiction are truly undermined. The certification procedure here at issue was developed to ensure that such decisions are correct, and had respondents examined the crucial issue in this case, they would have been forced to concede that certification was clearly required here.

This Court's prior rulings demonstrate that the need to refer an issue to a state court depends greatly upon the novelty of the issue. *Kaiser Steel Corp.* v. *W. S. Ranch Co.*, 391 U.S. 593 (1968). Respondents do not attempt to show that

the "fiduciary liability" theory adopted below is drawn from any common law principles expressed in Florida cases. They assert that the only issue in this case is one of "remedy". But such claim is clearly erroneous, since the doctrine invented below is no "remedy" for injured parties; instead, it awards a windfall to an undamaged entity from persons who owe it no duty. It stands conceded that the court below acted without precedent in Florida law in creating a wholly novel deterrent and punitive device.

Respondents merely dispute some of the effects of this new regulatory system. They claim that the new "Florida law" announced below, however illegitimate in its origins, will not affect existing Florida and federal policies, since such policies disfavor insider trading (R. Br. 18-20). But the novel issue which split the court below is not concern over insider trading, but rather the Florida corporation's asserted right to recover the proceeds on supposed "fiduciary" principles.

The majority position below, in directing such recovery, will have a very real impact upon the right of injured parties to recover their *actual* losses, a right respected under both Florida and federal law, see *Rogers* v. *Riddle,* 128 So.2d 409 (Fla. App.) *cert. denied,* 133 So.2d 645 (Fla. 1961); *Affiliated Ute Citizens* v. *United States,* 406 U.S. 128, 154-56 (1972). *Diamond* v. *Oreamuno,* 24 N.Y.2d 494, 248 N.E.2d 910 (1969), the New York case which originated the corporate recovery concept adopted and expanded below, created new practical and jurisdictional obstacles to individual recovery (see Lehman Br. 28-31). The ruling below only generates further uncertainties with respect to multiple liability of defendants and the availa ility of reimbursements for injured parties. Commentators have so noted. See Note, 26 VAND. L. REV. 1337, 1345-46 (1973); Note, 42 FORDHAM L. REV. 211, 223-24 (1973); Note, 87 HARV. L. REV. 675, 683 n.51 (1974).

A recent writer points out, moreover, that corporate recovery does not protect the same interests as do existing doctrines applicable to insider trading, and that these different interests may conflict:

> "For this reason, the dissent was correct in criticizing the *Schein* court's heavy reliance on the federal policy against insider trading as the policy justification for the extension of fiduciary liability to tippees. State law essentially protects the corporation and strives to maintain the loyalty of fiduciaries; federal law seeks to protect the trading markets and impose duties toward other traders. In some cases, these interests conflict rather than complement one another." Note, *supra*, 87 HARV. L. REV. at 683-84 (footnotes omitted).

B. In the absence of a statutory certification procedure, this would be a proper case for abstention.

Respondents assert that *Meredith* v. *Winter Haven*, 320 U.S. 228 (1943), *McNeese* v. *Board of Education*, 373 U.S. 668 (1963), and *Propper* v. *Clark*, 337 U.S. 472 (1949), bar abstention in this case. Although it is certification, and not abstention, which is the issue before the Court, we will briefly respond to this argument.

Meredith concerned a situation opposite to the instant case. There the circuit court dismissed the case because it doubted the "state of permanence of the decided law," *Meredith* v. *Winter Haven*, 134 F.2d 202, 206 (CA5 1943), even though a recent precedent existed.[1] In reversing, this Court stated that difficulties, arising from supposedly conflicting earlier decisions, in ascertaining "what the state courts may hereafter determine the state law to be" did not "in themselves" call for abstention, emphasizing that in such situation "the rulings of the Supreme Court of Florida in the *Andrews* case must be taken as controlling

1. *Andrews* v. *Winter Haven*, 148 Fla. 144, 3 So.2d 805 (1941).

here unless it can be said with some assurance that the Florida Supreme Court will not follow them in the future. . . ." *Meredith* v. *Winter Haven, supra,* 320 U.S. at 234. In contrast, no Florida precedent supports the result below or even suggests that such result might be favored at some future time. Rather, Florida principles of fiduciary liability to corporations would exclude such result (see Lehman Br. 23, 33-34). Refusal to abstain in this case cannot be justified by reference to state precedents, and *Meredith* thus would not govern this case.

McNeese is likewise inapposite, for it did not concern abstention at all, but only exhaustion of state administrative remedies in a suit under the Civil Rights Act, 42 U.S.C. § 1983. The Court rejected exhaustion, since it was "immaterial whether [a state official's] conduct is legal or illegal as a matter of state law," *id.*, 674, and anyway it was "by no means clear," *id.*, that state law gave an effective remedy. Here, in contrast, respondents' theories depend exclusively on state law, and the Florida certification procedure unquestionably provides an effective means to determine that law. *McNeese,* moreover, explicitly recognizes that

> "Where strands of local law are woven into the case that is before the federal court, we have directed a District Court to refrain temporarily from exercising its jurisdiction until a suit could be brought in the state court," *id.*, 673,[2]

citing both constitutional and nonconstitutional cases.

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2. See C.A. Wright, Law of Federal Courts § 52, at 197 (1970) (footnote omitted). The writer explains that in *McNeese* "the Court held that in a civil rights case exhaustion of state administrative remedies is not needed, but in doing so it specifically cited the abstention cases and distinguished them on the ground that in the case before it there was no issue of state law that might be dispositive."

Finally, in *Propper* v. *Clark, supra,* a federal question case, two lower courts had agreed on their interpretation of a New York statute, and this Court held only that it was "hesitant to overrule decisions by federal courts skilled in the law of particular states unless their conclusions are shown to be unreasonable," *id.,* 486-87. The Court determined that the lower courts' view was supported by New York decisions in analogous situations and was therefore "not unreasonable," *id.,* 489. Here, in contrast, the lower courts sharply disagreed. Moreover, they could not be viewed as skilled in the law of Florida, nor can the majority position below be viewed as reasonable under Florida precedents, since it rejects principles applied by Florida courts in analogous situations. Most importantly, this Court is not called upon to "overrule" the decision below and substitute this Court's views of the law of Florida, but solely to allow an authoritative decision by a Florida court.

The concern which led this Court to reject abstention in *Propper,* moreover, has no application here. There the Court noted that in certain cases separate state law issues had been submitted to state courts, but stressed the problem of confining state court proceedings to consideration of a single issue. It noted that the state court might decide the entire case and thus "the federal court might find itself blocked by *res judicata,*" 337 U.S. at 491. Certification, in contrast, solves such problems, for it enables the federal court to send a single question to the state courts while retaining all other questions of fact and law (see Lehman Br. 61-62).

C. Respondents' own authorities support certification here.

The commentators quoted by respondents clearly do not reject certification in a case like this one. The quotation from Gowen & Izlar, *Federal Court Abstention in Diversity of Citizenship Litigation,* 43 TEXAS L. REV. 194, 209 (1964), is employed out of context in respondents' brief; in fact, the

authors endorse certification.[3] Two other sources quoted by respondents (R. Br. 25, 26) oppose only misuse of certification, which is no argument against its use in a proper case like this one.[4] Professor Wright recognizes that

3. Rather than likening certification to abstention, the authors stress in the quoted passage that the two procedures are different in principle:

> "It would not seem, however, that the certification procedure is in effect a variation of abstention. The distinction made by the Fifth Circuit in the second *Clay* opinion between abstention and certification and the effect of each appears to be sound." *Id.*, 209.

The authors point out that, unlike abstention, certification does *not* entail any compromise of the statutory grant of diversity jurisdiction, since the federal decision is governed not by the *res judicata* effect of a state judgment but by the principle of *stare decisis*:

> "In other words, since lower state courts facing the same issue presumably will follow the opinion of the state supreme court in the certified question, there is little chance that a subsequent state decision will reach a result which conflicts with the federal decision. Therefore, one of the main problems involving diversity litigation is obviated. Thus, for the certification procedure to achieve a beneficial result from the standpoint of the federal courts it is necessary that state courts be bound to follow the certified answer. The federal courts by taking advantage of a certification procedure do not abnegate their responsibility to decide a diversity case. Although a certification procedure is used, it is in the federal court that the fact determinations are made, and it is in there that the law derived from the state court in its certified answer will be applied. Therefore, the diversity plaintiff has received all to which he is entitled." *Id.*, 210.

4. The author of Mattis, *Certification of Questions of State Law: An Impractical Tool in the Hands of the Federal Courts*, 23 U. MIAMI L. REV. 717 (1969), confesses to "a strong bias against certification," *id.*, 723 and claims to see no injustice in erroneous rulings on state law: "When state and federal courts reach different conclusions as to the law who is to say which of them arrived at the 'just' result?" *Id.*, 733. Nevertheless, he concedes the propriety of certification to avoid disruption of state policies by a variant federal decision. *Id.*, 731, 733.

The author of Kaplan, *Certification of Questions from Federal Appellate Courts to the Florida Supreme Court and its Impact on the Abstention Doctrine*, 16 U. MIAMI L. REV. 413 (1962), flatly states that [a]bstention is required in . . . cases when a decision by the

"it is hard to assay the present authoritativeness of *Meredith*," C. A. Wright, LAW OF FEDERAL COURTS § 52, at 203 (1970), in light of *Thibodaux and Mashuda*,[5] and opposes only such misuse of certification as might overturn *Meredith*, which does not govern this case. More to the point, he does not question the need for abstention in instances like *Kaiser* and this case, where a federal court is asked to inject its own views of good regulatory policy into a state's jurisprudence. *Id.*, § 52, at 200 n. 34.

The refusal of the court below to certify the central issue in this case has brought forth critical comment:

> ". . . Judge Kaufman's objection to the court's method of arriving at a determination of the applicable Florida law seems well-founded. . . . Despite the fact that neither the specific cause of action recognized in *Diamond* nor its extension in *Schein* had been considered by the Florida courts, the Second Circuit nevertheless decided that Florida would have permitted a derivative suit on behalf of a corporation against third parties who traded on inside information obtained from a fiduciary. In the absence of clear precedent, a federal court might be justified in assuming that the state would adhere to the rule generally applicable in other jurisdictions. Even so cautious a rule as this, however, would not alleviate the federal court's difficult *Erie* burden.
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> "Anticipating this type of problem, the Florida legislature enacted a statute authorizing federal appellate courts who are called upon to interpret Florida law to certify unsettled questions to the

federal courts would involve a determination of state domestic policy," *id.*, 417, and concludes that certification eliminates "some of the primary disadvantages of the abstention doctrine." *Id.*, 433.

5. *Louisiana Power & Light Co.* v. *City of Thibodaux*, 360 U.S. 25 (1959); *County of Allegheny* v. *Frank Mashuda Co.*, 360 U.S. 485 (1959).

> Florida Supreme Court." Note, *supra*, 87 HARV. L. REV. at 684-85 (footnotes omitted).

The writer concludes that certification in a case like this one provides "distinct advantages" in solving state law problems.

> "A clear decision by the highest court in the state would not only provide the most accurate determination of Florida law in the particular case, but would give both state and federal courts a precedent to rely on when the issue is presented in another case." *Id.*, 686.[6]

POINT II

No issue of waiver is presented

Rather than analyze the nature and implications of the new rule of "Florida law" announced below, respondents present the Court with a new theory of waiver, which they maintain supports a refusal to permit Florida to determine the fundamental public policy issue in this case. Thus, they point out that

> "petitioners, once confident of success and quite willing to have the Court below determine the applicable state law, have changed their view in the face of an adverse decision on the merits." (R. Br. 12).

And they repeatedly state (R. Br. 11, 12, 24, 27, 28, 30, 32, 34-37) that prior to the ruling below petitioners had not sought certification, although they sought it immediately thereafter.

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6. It should be noted that further research indicates that, in addition to the ten jurisdictions listed in our prior brief (Lehman Br. 69), the States of Minnesota and Oklahoma have adopted statutory certification procedures. MINN. STAT. ANN. § 480.061 (1973); OKLA. STAT. tit. 20 §§ 1601-13 (1973).

Respondents correctly state that petitioners were "confident of success" in the court below. It was petitioners' position below that the unusual *Diamond* doctrine was no part of Florida law, and that view has not changed. In the court below respondents presented no Florida authorities supporting a windfall recovery of insiders' trading profits by an undamaged corporation in a shareholder's derivative suit. No state other than New York had adopted such a radical deterrent device, there was not a hint in any Florida case that Florida might one day favor such a rule, much less expand it to "outside" nonfiduciaries, and in such circumstances affirmance of the District Court's dismissal seemed required.

Therefore there was no occasion for certification until after the decision below, since the law of Florida was not debatable or uncertain. The majority below, however, not only determined that the law of Florida was uncertain, but also took advantage of this supposed uncertainty in deciding to adopt an extreme minority rule as "the law of Florida". At this point the necessity for certification presented itself. Judge Kaufman so recognized and argued vigorously in dissent for certification. Petitioner likewise urged certification in its petition for rehearing. Accordingly, the claim of waiver on which respondents rely is wholly without substance.

Kaiser Steel Corp. v. *W. S. Ranch Co., supra,* presented a similar situation. There the petitioner filed a state court action in the New Mexico courts and sought rehearing before the Court of Appeals, urging abstention, only after the Tenth Circuit ruled against it on the key issue of New Mexico law. The Court of Appeals refused to abstain. On certiorari the respondent stressed that the state court

> "declaratory judgment suit raising the question was instituted and abstention requested only after the Court had rendered an adverse decision on the merits" (Brief in Opposition 2; see also *id.*, 7, 8, 18),

and labeled the petitioner's action as a "desperate, last-ditch effort" (*id.*, 8). Yet this Court, recognizing the recurrent and important nature of the public policy issue there present, and conscious that abstention also serves the public interest in sound judicial administration, put aside such arguments without discussion and ordered abstention pending state proceedings. Petitioner respectfully submits that respondents' "waiver" argument here deserves similar treatment.[7]

POINT III

There has been no exercise of discretion to which this Court may defer.

Respondents argue that the majority below declined to certify the crucial issue in this case in an exercise of discretion, to which this Court should defer. The fault in such an argument is that the majority failed to explain its refusal to certify the issue. When Judge Kaufman, in dissent, urged the majority to certify the issue so that it could be decided "authoritatively and finally" (81a), they simply ignored the point, and they did so again when the parties likewise urged certification in seeking rehearing. When a court so flatly ignores a point, it cannot be viewed as having exercised its considered judgment.

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7. Respondents attempt to support their "waiver" argument by citation of *England* v. *Louisiana State Board of Medical Examiners*, 375 U.S. 411 (1964). *England* is inapposite, since it concerns not waiver but *res judicata*, which is plainly inapplicable here, since this litigation has not concluded. Moreover, *England* holds that a litigant can request a state court not to decide a federal issue, and that such issue can later be presented to a federal court, even after judgment in the state court, and despite the fact that state and federal courts have equal authority to decide such issues. Here, in "a reverse situation" (R. Br. 34) except that the litigation is *not* concluded, petitioners request the federal courts to permit a state law issue to be determined by the state court, which has the sole authority to decide such issues conclusively. Such action is wholly in accord with *England*, which recognizes "state courts as the final expositors of state law," *id.*, 415.

The respondent in *Kaiser* similarly argued at length that the court below had properly exercised its discretion in refusing to abstain (Brief in Opposition 10-18). There, as here, the court below had completely failed to state reasons for its action, despite forceful arguments in dissent. This Court refused to defer to such unexplained action and unanimously reversed. The same action is called for in the present case.

CONCLUSION

The judgment of the Court of Appeals for the Second Circuit should be reversed and this case should be remanded with instructions to certify the controlling issue of Florida law to the Supreme Court of Florida for decision by that Court.

Respectfully submitted,

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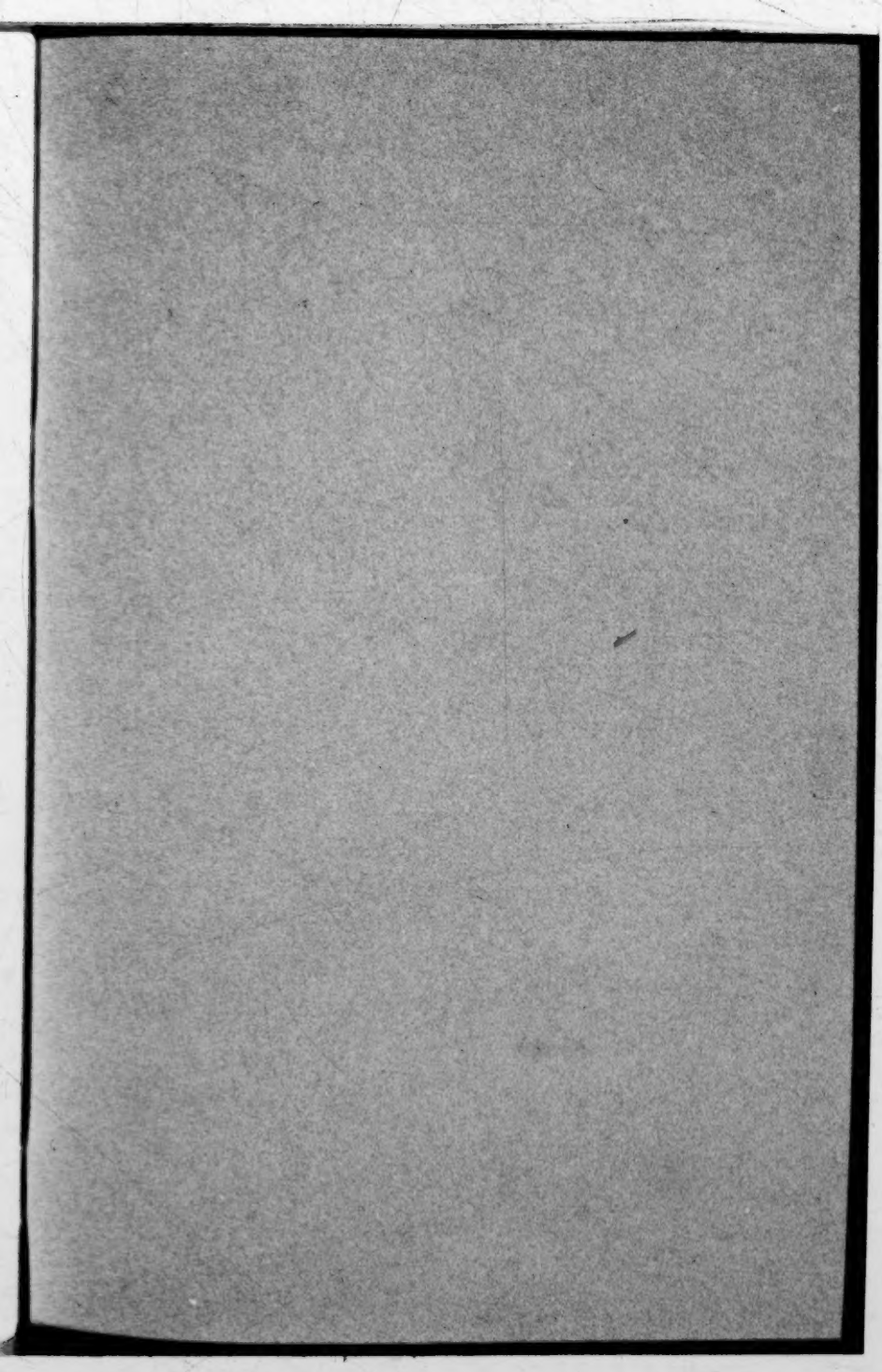

LEHMAN BROTHERS *v.* SCHEIN ET AL.

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

No. 73–439. Argued March 19, 1974—Decided April 29, 1974*

Shareholders' derivative diversity suits were brought in federal court in New York, alleging that the president of a Florida corporation as a fiduciary, with others, used inside information about projected corporate earnings for profit and hence was liable to the corporation for the unlawful profits. The District Court, looking to New York's choice-of-law rules, held that under Florida law, which it held governed, the defendants were not liable, and dismissed the complaints. The Court of Appeals reversed, finding that Florida law, though controlling, was not decisive, and that in this situation, Florida "would probably" apply a certain New York decision to impose liability. *Held:* While resort to an available certification procedure, such as is available in Florida, is not obligatory where there is doubt as to local law, and its use in a given case is discretionary, resort to such procedure seems particularly appropriate here in view of the novelty of the question, the unsettled state of Florida law, and the fact that when federal judges in New York attempt to predict uncertain Florida law, they act as "outsiders" not exposed to local law. Hence, the case is remanded to the Court of Appeals to reconsider whether the controlling issue of state law should be certified to the Florida Supreme Court. Pp. 389–392.

478 F. 2d 817, vacated and remanded.

DOUGLAS, J., delivered the opinion for a unanimous Court. REHNQUIST, J., filed a concurring opinion, *post*, p. 392.

James J. Hagan argued the cause for all petitioners. With him on the briefs for petitioner in No. 73–439 was *Stephen P. Duggan*. *David Hartfield, Jr.*, and *Laura*

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* Together with No. 73–440, *Simon* v. *Schein et al.*, and No. 73–495, *Investors Diversified Services, Inc., et al.* v. *Schein et al.*, also on certiorari to the same court.

Banfield were on the brief for petitioner in No. 73–440. *James V. Hayes, John E. Tobin, Richard Y. Holcomb,* and *Allan R. Freedman* were on the briefs for petitioners in No. 73–495.

Donald N. Ruby argued the cause for all respondents. With him on the brief were *Benedict Wolf, Edward A. Berman,* and *Victor P. Muskin.*

MR. JUSTICE DOUGLAS delivered the opinion of the Court.

These cases are here on petitions for certiorari and raise one identical question.

These are suits brought in the District Court for the Southern District of New York. Lum's, one of the respondents in the *Lehman Brothers* petition, is a Florida corporation with headquarters in Miami. Each of the three petitions which we consolidated for oral argument involves shareholders' derivative suits naming Lum's and others as defendants; and the basis of federal jurisdiction is diversity of citizenship, 28 U. S. C. § 1332 (a)(1), about which there is no dispute.

The complaints allege that Chasen, president of Lum's, called Simon, a representative of Lehman Bros., and told him about disappointing projections of Lum's earnings, estimates that were confidential, not public. Simon is said to have told an employee of IDS [1] about them. On the next day, it is alleged that the IDS defendants sold

[1] Investors Diversified Services, Inc., Investors Variable Payment Fund, Inc., and IDS New Dimensions Fund, Inc., were defendants in the *Schein* case. Of those, only Investors Diversified Services, Inc., is a defendant in the other derivative action brought by Gregorio. The dismissal of the third derivative action (*Gildenhorn*) was not pursued on appeal.

One Sit and one Jundt, defendants alleged to be employees of IDS, Inc., were dismissed from the case by the District Court for lack of personal jurisdiction. There was no appeal from that dismissal.

83,000 shares of Lum's on the New York Stock Exchange for about $17.50 per share. Later that day the exchanges halted trading in Lum's stock and on the next trading day it opened at $14 per share, the public being told that the projected earnings would be "substantially lower" than anticipated. The theory of the complaints was that Chasen was a fiduciary but used the inside information along with others for profit and that Chasen and his group are liable to Lum's for their unlawful profits.

Lehman and Simon defended on the ground that the IDS sale was not made through them and that neither one benefited from the sales. Nonetheless plaintiffs claimed that Chasen and the other defendants were liable under *Diamond* v. *Oreamuno*, 24 N. Y. 2d 494, 248 N. E. 2d 910 (1969). *Diamond* proceeds on the theory that "inside" information of an officer or director of a corporation is an asset of the corporation which had been acquired by the insiders as fiduciaries of the company and misappropriated in violation of trust.

The District Court looked to the choice-of-law rules of the State of New York, *Klaxon Co.* v. *Stentor Electric Mfg. Co.*, 313 U. S. 487 (1941), and held that the law of the State of incorporation governs the existence and extent of corporate fiduciary obligations, as well as the liability for violation of them. *Diamond* did, indeed, so indicate, 24 N. Y. 2d, at 503–504, 248 N. E. 2d, at 915.

The District Court in examining Florida law concluded that, although the highest court in Florida has not considered the question, several district courts of appeal indicate that a complaint which fails to allege both wrongful acts and damage to the corporation must be dismissed.[2] The District Court went on to consider whether if Florida followed the *Diamond* rationale, defendants would be liable. It concluded that the

[2] *E. g.*, *Palma* v. *Zerbey*, 189 So. 2d 510, 511 (Fla. App. 1966).

present complaints go beyond *Diamond*, as Chasen, the only fiduciary of Lum's involved in the suits, never sold any of his holdings on the basis of inside information. The other defendants were not fiduciaries of Lum's.[3] The District Court accordingly dismissed the complaints, 335 F. Supp. 329 (SDNY 1971).

The Court of Appeals by a divided vote reversed the District Court. 478 F. 2d 817 (CA2 1973). While the Court of Appeals held that Florida law was controlling, it found none that was decisive. So it then turned to the law of other jurisdictions, particularly that of New York, to see if Florida "would probably" interpret *Diamond* to make it applicable here. The Court of Appeals concluded that the defendants had engaged with Chasen "to misuse corporate property," *id.*, at 822, and that the theory of *Diamond* reaches that situation, "viewing the case as the Florida court would probably view it." *Ibid.* There were emanations from other Florida decisions[4] that made the majority on the Court of Appeals feel that Florida would follow that reading of *Diamond*. Such a construction of *Diamond*, the Court of Appeals said, would have "the prophylactic effect of providing a disincentive to insider trading." *Id.*, at 823. And so it would. Yet under the regime of *Erie R. Co.* v. *Tompkins*, 304 U. S. 64 (1938), a State can make just the opposite her law, providing there is no overriding federal rule which pre-empts state law by reason of federal curbs on trading in the stream of commerce.

The dissenter on the Court of Appeals urged that that court certify the state law question to the Florida Supreme Court as is provided in Fla. Stat. Ann. § 25.031

[3] The District Court also held that whether Chasen would be liable not for profiting himself from the inside information but for revealing it to others could not be reached as Chasen, a nonresident of New York, had not been properly served.

[4] See, *e. g.*, *Quinn* v. *Phipps*, 93 Fla. 805, 113 So. 419 (1927).

and its Appellate Rule 4.61. That path is open to this Court and to any court of appeals of the United States. 478 F. 2d, at 828. We have, indeed, used it before [5] as have courts of appeals.[6]

Moreover when state law does not make the certification procedure available,[7] a federal court not infrequently will stay its hand, remitting the parties to the state court to resolve the controlling state law on which the federal rule may turn. *Kaiser Steel Corp.* v. *W. S. Ranch Co.*, 391 U. S. 593 (1968). Numerous applications of that practice are reviewed in *Meredith* v. *Winter Haven*, 320 U. S. 228 (1943), which teaches that the mere difficulty in ascertaining local law is no excuse for remitting the parties to a state tribunal for the start of another lawsuit. We do not suggest that where there is doubt as to local law and where the certification procedure is available,

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[5] *Aldrich* v. *Aldrich*, 375 U. S. 249 (1963); *Dresner* v. *City of Tallahassee*, 375 U. S. 136 (1963).

[6] *Trail Builders Supply Co.* v. *Reagan*, 430 F. 2d 828 (CA5 1970); *Gaston* v. *Pittman*, 413 F. 2d 1031 (CA5 1969); *Martinez* v. *Rodriquez*, 410 F. 2d 729 (CA5 1969); *Moragne* v. *States Marine Lines, Inc.*, 409 F. 2d 32 (CA5 1969), rev'd on other grounds, 398 U. S. 375 (1970); *Hopkins* v. *Lockheed Aircraft Corp.*, 394 F. 2d 656 (CA5 1968); *Life Ins. Co. of Virginia* v. *Shifflet*, 380 F. 2d 375 (CA5 1967); *Green* v. *American Tobacco Co.*, 325 F. 2d 673 (CA5 1963); *Sun Insurance Office* v. *Clay*, 319 F. 2d 505 (CA5 1963). The Fifth Circuit's willingness to certify is in part a product of frequent state court repudiation of its interpretations of state law. See the cases summarized in *United Services Life Ins. Co.* v. *Delaney*, 328 F. 2d 483, 486–487 (CA5 1964) (Brown, C. J., concurring).

[7] Certification procedures are available in several States, including Colorado, Colo. Appellate Rule 21.1 (1970); Hawaii, Haw. Rev. Stat. § 602–36 (1969); Louisiana, La. Rev. Stat. Ann. § 13:72.1 (Supp. 1973); Maine, Me. Rev. Stat. Ann., Tit. 4, § 57 (1964); Maryland, Md. Ann. Code, Art. 26, § 161 (Supp. 1973); Massachusetts, Mass. Sup. Jud. Ct. Rule 3:21 (1973); Montana, Mont. Sup. Ct. Rule 1 (1973); New Hampshire, N. H. Rev. Stat. Ann. § 490 App. R. 20 (Supp. 1973); and Washington, Wash. Rev. Code Ann. §§ 2.60.010–2.60.030 (Supp. 1972).

resort to it is obligatory. It does, of course, in the long run save time, energy, and resources and helps build a cooperative judicial federalism.[8] Its use in a given case rests in the sound discretion of the federal court.

Here resort to it would seem particularly appropriate in view of the novelty of the question and the great unsettlement of Florida law, Florida being a distant State. When federal judges in New York attempt to predict uncertain Florida law, they act, as we have referred to ourselves on this Court in matters of state law, as "outsiders" lacking the common exposure to local law which comes from sitting in the jurisdiction.

> "Reading the Texas statutes and the Texas decisions as outsiders without special competence in Texas law, we would have little confidence in our independent judgment regarding the application of that law to the present situation. The lower court did deny that the Texas statutes sustained the Commission's assertion of power. And this represents the view of an able and experienced circuit judge of the circuit which includes Texas and of two capable district judges trained in Texas law." *Railroad Comm'n* v. *Pullman Co.*, 312 U. S. 496, 499 (1941).

See also *MacGregor* v. *State Mutual Life Assur. Co.*, 315 U. S. 280, 281 (1942); *Reitz* v. *Mealey*, 314 U. S. 33, 39 (1941).

The judgment of the Court of Appeals is vacated and the cases are remanded so that that court may reconsider

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[8] See Wright, The Federal Courts and the Nature and Quality of State Law, 13 Wayne L. Rev. 317 (1967); Kurland, Toward a Co-Operative Judicial Federalism: The Federal Court Abstention Doctrine, 24 F. R. D. 481 (1960); Note, Inter-Jurisdictional Certification: Beyond Abstention Toward Cooperative Judicial Federalism, 111 U. Pa. L. Rev. 344 (1963); Note, Florida's Interjurisdictional Certification: A Reexamination To Promote Expanded National Use, 22 U. Fla. L. Rev. 21 (1969).

whether the controlling issue of Florida law should be certified to the Florida Supreme Court pursuant to Rule 4.61 of the Florida Appellate Rules.

So ordered.

MR. JUSTICE REHNQUIST, concurring.

The Court says that use of state court certification procedures by federal courts "does, of course, in the long run save time, energy, and resources and helps build a cooperative judicial federalism." *Ante*, at 391. It also observes that "[w]e do not suggest that where there is doubt as to local law and where the certification procedure is available, resort to it is obligatory," *ante*, at 390–391, and further states that "[i]ts use in a given case rests in the sound discretion of the federal court." *Ante*, at 391. I agree with each of these propositions, but I think it appropriate to emphasize the scope of the discretion of federal judges in deciding whether to use such certification procedures.

Petitioners here were defendants in the District Court. That court, applying applicable New York choice-of-law rules, decided that Florida law governs the case and, finding that the respondents' complaint requested relief which would extend the substantive law even beyond New York's apparently novel decision in *Diamond* v. *Oreamuno*, 24 N. Y. 2d 494, 248 N. E. 2d 910 (1969), dismissed the complaint on the merits. The Court of Appeals agreed that Florida law applied, but held that Florida law would permit recovery on the claim stated by respondents. The opinion of the dissenting judge of the Court of Appeals, disagreeing with the majority's analysis of Florida law, added in a concluding paragraph that in light of the uncertainty of Florida law, the Florida certification procedure should have been utilized by the Court of Appeals. On rehear-

ing, petitioners requested the Court of Appeals to utilize this procedure, but they concede that this is the first such request that they made. Thus petitioners seek to upset the result of more than two years of trial and appellate litigation on the basis of a point which they first presented to the Court of Appeals upon petition for rehearing. Cf. *Hostetter* v. *Idlewild Liquor Corp.*, 377 U. S. 324, 329 (1964).

The authority which Congress has granted this Court to review judgments of the courts of appeals undoubtedly vests us not only with the authority to correct errors of substantive law, but to prescribe the method by which those courts go about deciding the cases before them. *Western Pacific Railroad Case*, 345 U. S. 247 (1953). But a sensible respect for the experience and competence of the various integral parts of the federal judicial system suggests that we go slowly in telling the courts of appeals or the district courts how to go about deciding cases where federal jurisdiction is based on diversity of citizenship, cases which they see and decide far more often than we do.

This Court has held that a federal court may not remit a diversity plaintiff to state courts merely because of the difficulty in ascertaining local law, *Meredith* v. *Winter Haven*, 320 U. S. 228 (1943); it has also held that unusual circumstances may require a federal court having jurisdiction of an action to nonetheless abstain from deciding doubtful questions of state law, *e. g.*, *Louisiana Power & Light Co.* v. *City of Thibodaux*, 360 U. S. 25 (1959); *Kaiser Steel Corp.* v. *W. S. Ranch Co.*, 391 U. S. 593 (1968) (*per curiam*). In each of these situations, our decisions have dealt with the issue of how to reconcile the exercise of the jurisdiction which Congress has conferred upon the federal courts with the important considerations of comity and cooperative federalism which

are inherent in a federal system, both of which must be subject to a single national policy within the federal judiciary.

At the other end of the spectrum, however, I assume it would be unthinkable to any of the Members of this Court to prescribe the process by which a district court or a court of appeals should go about researching a point of state law which arises in a diversity case. Presumably the judges of the district courts and of the courts of appeals are at least as capable as we are in determining what the Florida courts have said about a particular question of Florida law.

State certification procedures are a very desirable means by which a federal court may ascertain an undecided point of state law, especially where, as is the case in Florida, the question can be certified directly to the court of last resort within the State. But in a purely diversity case such as this one, the use of such a procedure is more a question of the considerable discretion of the federal court in going about the decisionmaking process than it is a question of a choice trenching upon the fundamentals of our federal-state jurisprudence.

While certification may engender less delay and create fewer additional expenses for litigants than would abstention, it entails more delay and expense than would an ordinary decision of the state question on the merits by the federal court. See *Clay* v. *Sun Insurance Office*, 363 U. S. 207, 226–227 (1960) (dissenting opinion). The Supreme Court of Florida has promulgated an appellate rule, Fla. Appellate Rule 4.61 (1967), which provides that upon certification by a federal court to that court, the parties shall file briefs there according to a specified briefing schedule, that oral argument may be granted upon application, and that the parties shall pay the costs of the

certification.* Thus while the certification procedure is more likely to produce the correct determination of state law, additional time and money are required to achieve such a determination.

If a district court or court of appeals believes that it can resolve an issue of state law with available research materials already at hand, and makes the effort to do so, its determination should not be disturbed simply because the certification procedure existed but was not used. The question of whether certification on the facts of this case, particularly in view of the lateness of its suggestion by petitioners, would have advanced the goal of correctly disposing of this litigation on the state law issue is one which I would leave, and I understand that the Court would leave, to the sound judgment of the court making the initial choice. But since the Court has today for the first time expressed its view as to the use of certification procedures by the federal courts, I agree that it is appropriate to vacate the judgment of the Court of Appeals and remand the cases in order that the Court of Appeals may reconsider certification in light of the Court's opinion.

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*Fla. Appellate Rule 4.61 (1967) provides in part:

"f. Costs of Certificate. The costs of the certificate and filing fee shall be equally divided between the parties unless otherwise ordered by this Court.

"g. Briefs and Argument. The appellant or moving party in the federal court shall file and serve upon its adversary its brief on the question certified within 30 days after the filing of said certificate in the appellate court of this state having jurisdiction. The appellee or responding party in the federal court shall file and serve upon its adversary its brief within 20 days after the receipt of appellant's or moving party's brief and a reply brief shall be filed within 10 days thereafter.

"h. Oral Argument. Oral argument may be granted upon application and, unless for good cause shown the time be enlarged by special order of the Court prior to the hearing thereon, the parties shall be allowed the same time as in other causes on the merits."